No. 06-1265

Title: Klein & Co. Futures, Inc., Petitioner

v.

Board of Trade of the City of New York, et al.

Docketed: March 19, 2007

Lower Ct: United States Court of Appeals for the Second Circuit

Case Nos.: (05-1374, 05-1662, 05-1702, 05-1718)

Decision Date: September 18, 2006

Rehearing Denied: November 14, 2006

Questions Presented

| ~~Date~~ | ~~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~ |
|---|---|
| Jan 31 2007 | Application (06A752) to extend the time to file a petition for a writ of certiorari from February 12, 2007 to March 14, 2007, submitted to Justice Ginsburg. |
| Jan 31 2007 | Application (06A752) granted by Justice Ginsburg extending the time to file until March 14, 2007. |
| Mar 14 2007 | Petition for a writ of certiorari filed. (Response due April 18, 2007) |
| Apr 11 2007 | Waiver of right of respondents Norman Eisler, et al. to respond filed. |
| Apr 18 2007 | Brief amicus curiae of Futures Industry Association, Inc. filed. |
| Apr 18 2007 | Brief of respondents Board of Trade of the City of New York, et al. in opposition filed. |
| Apr 30 2007 | Reply of petitioner Klein & Co. Futures, Inc. filed. |
| May 1 2007 | DISTRIBUTED for Conference of May 17, 2007. |
| May 21 2007 | Petition GRANTED. |
| May 31 2007 | Waiver to file briefs on the merits filed by counsel for Norman Eisler, et al. |
| Jun 21 2007 | The time within which to file the joint appendix and petitioner's brief on the merits is extended to and including July 19, 2007. |
| Jul 19 2007 | Brief amicus curiae of United States filed. |
| Jul 19 2007 | Brief amicus curiae of Futures Industry Association, Inc. filed. |
| Jul 19 2007 | Brief of petitioner Klein & Co. Futures, Inc. filed. |
| Jul 19 2007 | Joint appendix filed. |
| Aug 9 2007 | Statement of costs for the printing of the joint appendix received. |
| Aug 17 2007 | The time within which to file respondents' brief on the merits is extended to and including September 13, 2007. |
| Aug 30 2007 | SET FOR ARGUMENT Monday, October 29, 2007. |
| Sep 12 2007 | Record received from U.S.D.C. for Southern District of New York. (1 box) |
| Sep 13 2007 | Brief of respondents Board of Trade of the City of New York, et al. filed. |
| Sep 17 2007 | CIRCULATED. |

| | |
|---|---|
| Sep 21 2007 | Record received from U.S.C.A. for the Second Circuit. (1 Box) |
| Sep 27 2007 | Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed. |
| Oct 9 2007 | Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED. |
| Oct 18 2007 | Reply of petitioner Klein & Co. Futures, Inc. filed. (Distributed) |
| Oct 29 2007 | Argued. For petitioner: Drew S. Days, III, Washington, D.C.; and Malcolm L. Stewart, Assistant to the Solicitor General, Department of Justice, Washington, D.C. (for United States, as amicus curiae.) For respondents: Andrew J. Pincus, Washington, D.C. |

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No. 06-061265

In The

# Supreme Court of the United States

KLEIN & CO. FUTURES, INC.,

*Petitioner*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., *et al.*

**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit**

## PETITION FOR A WRIT OF CERTIORARI

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## QUESTION PRESENTED

The Commodity Exchange Act provides an express private right of action for actual losses to a person who "engaged in any transaction on" or "subject to the rules of" a commodity board of trade against that board of trade if the board, in bad faith, engaged in illegal conduct that caused the person to suffer the actual losses, 7 U.S.C. § 25(b)(1).

The question presented is:

Whether the court of appeals erred in concluding that futures commission merchants lack statutory standing to invoke that right of action because, in the court's view, they do not engage in such transactions, despite the statutory requirement that the merchants enter into and execute their transactions on, and subject to the rules of, a board of trade and the fact of the merchants' financial liability for the transactions.

## PARTIES TO THE PROCEEDING

Petitioner is Klein & Co. Futures, Inc. The respondents to the proceeding in the court whose judgment is sought to be reviewed are the Board of Trade of the City of New York, Inc.; the New York Clearing Corporation; the New York Cotton Exchange, Inc.; and the New York Futures Exchange.

Mark D. Fichtel; Albert Weis; Jeff Soman; Charles Sweeney; Al Peres; Chris Meek; George Haase; Lawrence Gulitti; Bryan Sayler; Nitesh Trivedi; Joseph O'Neill; Walter Fair; Evan Thomas; and Joseph Jach also were appellees in the court below, but petitioner does not seek review of the court of appeals' ruling affirming their dismissal from the dispute.

Norman Eisler and First West Trading, Inc. were defendants in the proceedings before the United States District Court, but petitioner did not appeal their dismissal from the dispute.

## RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of the Supreme Court, petitioner Klein & Co. Futures, Inc. hereby states that it has no parent company, and no public company owns 10% or more of its stock.

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## PETITION FOR A WRIT OF CERTIORARI

Klein & Co. Futures, Inc. (Klein) respectfully petitions for a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Second Circuit.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit (App., *infra*, 1a-15a) is reported at 464 F.3d 255 (2006). The opinion of the United States District Court for the Southern District of New York granting respondents' motion for summary judgment (App., *infra*, 16a-34a) is unreported.

## JURISDICTION

The court of appeals entered its judgment on September 18, 2006. A petition for rehearing and rehearing *en banc* was denied on November 14, 2006. Justice Ginsburg, on January 31, 2007, granted an extension of time within which to file a petition for a writ of *certiorari* to and including March 14, 2007. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

The Commodity Exchange Act, 7 U.S.C. § 1 *et seq.*, as in effect on July 26, 2000, when this case was filed,[1] provides in relevant part:

[1] The statute was amended on December 21, 2000 but the amendments to this section of the statute were merely technical.

**Sec. 25 Private rights of action**

* * *

(b) Liabilities of organizations and individuals; bad faith requirement; exclusive remedy

(1)(A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by sections 7(a)(8) and 9 of this title,

(B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or

(C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this chapter or any Commission rule, regulation, or order,

shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

7 U.S.C. § 25(b)(1).

Other relevant provisions of the Commodity Exchange Act are set forth in the appendix to this brief at App., *infra*, 37a-41a.

## INTRODUCTION

Almost two billion contracts are traded in the United States futures market annually, and more than $100 billion of equity is invested in this market. Congress, in

enacting the Commodity Exchange Act, recognized that a stable commodities futures market is vital to the financial well-being of the nation. If left unreviewed, the ruling below will impose significant costs on trading on the futures markets and undermine those markets' stability.

The court of appeals below denied to futures commission merchants, who are statutorily authorized market participants, a private right of action against the boards of trades and clearinghouses that operate the markets. Congress created that private right of action as a means to protect against market manipulation. The inability of these merchants to recover actual losses caused by a board of trade's bad faith violation of the governing statute, regulation, or rules will substantially undermine enforcement of those laws. Without the right of action, the risk of economic loss rests on the merchants rather than on the wrongdoers who cause or are required to enforce rules designed to prevent the actual losses. That risk of loss will be spread to investors, which will contribute to a more inelastic and expensive commodities market that ultimately will be more susceptible to price manipulation.

The ruling below stands in conflict with other circuits on the role of futures commission merchants under the statutory framework. The court of appeals' denial to futures commission merchants of their private right of action is rooted in that court's fundamental misunderstanding of the role of such merchants as federally regulated entities in a multi-faceted enforcement scheme constructed by Congress. By contrast, the Seventh Circuit (the other jurisdiction in which many commodity exchanges are concentrated) and other circuits correctly recognize the role that Congress intended these merchants to play as entities that engage in transactions subject to the rules of a board of trade.

This Court should grant the petition for a writ of *certiorari* to address this issue of national economic importance and reverse the clearly erroneous

interpretation of the Commodity Exchange Act that undermines the regulation of the nation's futures markets.

## STATEMENT OF THE CASE

### 1. Statutory And Regulatory Framework

a. A futures contract is an agreement to buy or sell on a commodity exchange a quantity of a particular commodity in the future. The parties to a futures contract agree on a price for the commodity to be delivered, or paid for, at a set time in the future, known as the "settlement date." Most futures contracts are closed prior to the delivery date, however. Thus, the commodity exchange serves, in essence, as a market where investors trade futures contracts to shift the inherent market risks of price increases and decreases onto others who are willing to assume that market risk for profit opportunity.[2]

A commodity exchange is operated by a board of trade, such as respondent, the Board of Trade of the City of New York, which operates a market for, *inter alia*, certain sugar, coffee, and cocoa; and cotton and orange juice contracts. *See* http://www.nybot.com (last visited Mar. 7, 2007). A clearinghouse, such as respondent, the New York Clearing Corporation, works with a board of trade to clear the trades on the exchange.

In order to protect the public from price manipulation on these robust, high-volume markets, Congress has subjected boards of trade and their participants to extensive oversight, through the Commodity Exchange Act

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[2] Option contracts also are traded on the commodity exchanges. An option contract gives an investor the option (*i.e.*, the right but not the obligation) to enter a particular futures contract on a given day at a particular price. Although the instant dispute involves both futures and option contracts, for the purposes of this petition the distinctions between the two make no difference and we use the term "futures contracts" to refer to both.

(CEA), 7 U.S.C. § 1 *et seq.* Congress has ensured compliance in this self-regulatory statutory scheme through the threat of public and private enforcement. Congress established the Commodity Futures Trading Commission (CFTC) as the primary regulator of boards of trade under the CEA. A board of trade has a statutory obligation to establish rules to prevent market manipulation and to ensure fair and equitable trading on its exchanges. *Id.* § 7(b). Congress has specified that any commodity futures transactions must be "conducted on or subject to the rules of a board of trade." 7 U.S.C. § 6(a)(1).

b. Investors do not buy and sell futures on a commodity exchange. Rather, futures commission merchants ("merchants") engage in and are financially liable for the transactions on a commodity exchange.[3] Futures commission merchants are defined by Congress as individuals or entities that "solicit[] or * * * accept[] orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market." 7 U.S.C. § 1a(20)(A). Merchants may "accept[] any money, securities, or property (or extend[] credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom." 7 U.S.C. § 1a(20)(B).

Congress authorized boards of trade to establish rules that allow futures commission merchants "to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization." 7 U.S.C. § 7(b)(3)(C). Merchants use floor brokers to execute the trades on the floor of the exchange. Both merchants and floor brokers must be registered with the CFTC. *See* 7 U.S.C. § 6d(a)(1), f(a).

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[3] A commodity exchange and its board of trade are also known as a "contract market." 7 U.S.C. § 7.

A futures transaction is an ongoing relationship among the investor, the futures commission merchant, and the board of trade and its clearinghouse. An investor who holds an account with a merchant must make a minimum "margin payment" on its contracts, and the level of margin required is established by the rules of the board of trade in accordance with CEA and CFTC regulations. The payment generally is a relatively small percentage of the value of the investor's market position (*i.e.*, the price of the futures multiplied by the quantity of the futures), which allows the investor to leverage his funds.

Settlement prices of commodity contracts are used to determine whether additional margin payments in connection with open contract positions are required. The settlement prices are calculated, on a daily basis, by the board of trade and its clearinghouse for whatever contracts are then being held in the accounts of futures commission merchants who are also clearing members. Settlement prices reflect the daily closing value of the contract and often are at, or very near, the price of the last trade. In thinly traded markets – *i.e.*, where there is infrequent trading – however, there can be a significant difference between the settlement price and the price of the most recent trades.[4] As required by the CEA to maintain the financial integrity of all transactions, each board of trade maintains rules as to how settlement prices are calculated at closing. *See* 7 U.S.C. § 7(b)(5).

If an investor's contracts increase in value during the day, the clearinghouse credits the merchant's account, which, in turn, credits the account that the investor has with the merchant. Conversely, if the investor's contracts

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[4] A number of other factors can contribute to the determination of a settlement price. *See In the Matter of Norman Eisler and First West Trading, Inc.*, CFTC No. 01-14, 2004 WL 77924 at *1-2 (C.F.T.C. Jan. 20, 2004).

lose value during the day, the clearinghouse debits the merchant's account, which, in turn, debits the investor's margin account. *See, e.g.*, NYCC Rules 501-504. This relationship occurs because the clearinghouse transacts only with the clearing member futures commission merchant in a single account, irrespective of the number of accounts that merchant might have with individual investors.

If the balance of an investor's margin account with the merchant declines below the board of trade's minimum margin level, the futures commission merchant requires the investor to provide additional funds to the account to restore the initial margin level to its required percentage of the settlement value of his contract. Failure by an investor to meet such a margin call within the allotted period of time (which can be as little as one hour) permits a merchant to immediately liquidate the investor's contract positions in order to reduce the margin deficiency and risk. If an investor's position is liquidated at a loss, the investor is liable to the merchant for the deficiency. Significantly, however, it is the merchant that is legally liable to the board of trade for the difference. *See* CFTC, *Report on Lessons Learned from the Failure of Klein & Co. Futures, Inc.* at 2 (July 2001) ("Clearinghouses look to the funds and credit of clearing FCMs [futures commission merchants] for satisfaction of trading obligations rather than to the actual floor broker, floor trader, or other customer.").

c. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), this Court held that there was an implied private right of action for a violation of the CEA's statutory prohibition against fraudulent and deceptive conduct and its provisions designed to prevent price manipulation.

Shortly after that ruling, Congress enacted express private rights of action for violation of the statute, the implementing regulations, or the rules of a board of trade.

*See* Futures Trading Act of 1982, Pub. L. No. 97-444, § 235, 96 Stat. 2294, 2322-2324 (1982). Two primary rights of action are set forth in 7 U.S.C. § 25(a)(1) and 25(b)(1).

Section 25(a)(1) provides a private right of action for actual damages against a person (other than a board of trade or futures association) that violates the statute, *e.g.*, an action against merchants and brokers. The right of action is conferred only on four categories of persons: (A) any person that received trading advice from the alleged wrongdoer; (B) any person that made a contract of sale through the alleged wrongdoer or deposited funds with him; (C) any person that purchased from, sold to, or placed an order for purchase with or through the alleged wrongdoer for an option not sold on a board of trade, contract, or interest in a commodity pool; and (D) any person that purchased or sold a contract if the violation by the alleged wrongdoer constitutes a manipulation of the price of the contract or underlying commodity. 7 U.S.C. § 25(a)(1)(A)-(D). The most common action under Section 25(a)(1) is a suit by an investor against a merchant or a broker due to a trading loss by the investor.

Section 25(b)(1) provides a private right of action for actual damages against any board of trade designated as a contract market who fails to enforce any bylaws, rules, regulations or resolutions that the entity is charged by statute with enforcing; against a licensed board of trade that fails to enforce any bylaw, rule, regulation or resolution it is required by the CFTC to enforce; and against any board of trade that enforces such provisions in a manner that violates the statute or a CFTC rule, regulation or order.

That Section 25(b)(1) right of action – the right of action at issue here – is not conferred only on the four categories of persons in Section 25(a)(1)(A)-(D). Rather, it is conferred on any person "who engaged in any transaction on" or "subject to the rules of" the board of trade or clearinghouse, but only "to the extent" of that person's "actual losses that resulted from such transaction and were caused by such failure to

enforce or enforcement of such bylaws, rules, regulations, or resolutions." 7 U.S.C. § 25(b)(1).

The statute confers other specific rights of actions for bylaw or rule violations by registered futures associations, 7 U.S.C. § 25(b)(2), and for violations by individual officers, directors and the like of boards of trade, clearinghouses, or futures associations. 7 U.S.C. § 25(b)(3). Those rights of action are conferred only on the four categories of persons specified in Section 25(a)(1)(A)-(D).

Congress provided that the statutory rights of action are exclusive remedies under the statute in most circumstances. 7 U.S.C. §§ 25(a)(2), 25(b)(5). Congress also specified that a person seeking to hold liable a board of trade or futures association or its officer, director or the like, must establish bad faith on the defendant's part in failing to act or in acting, and that such failure to act or action caused the loss. 7 U.S.C. § 25(b)(4).

## 2. Factual And Procedural Background

a. Petitioner Klein & Co. Futures, Inc. (Klein) brought this action under 7 U.S.C. § 25 against the various respondents, including the Board of Trade of the City of New York (the Board of Trade), its clearinghouse and various individuals. The case arose out of price manipulation by Norman Eisler who was the chairman of the New York Futures Exchange (the Exchange), which is a division of the Board of Trade, both of which are contract markets under the statute. Eisler was a member of the Exchange's settlement committee.

Eisler owned a company, First West Trading, Inc. (First West), that invested heavily in P-Tech futures – a futures traded on the Exchange. From approximately August 1999 through May 12, 2000, Eisler, as the member of the Exchange's settlement committee who determined the daily settlement prices of P-Tech futures, manipulated the daily settlement prices of those futures to ensure that

his company's contracts appeared profitable and avoided margin calls. *See Matter of Norman Eisler,* 2004 WL 77924 at *2-3.

The CFTC ultimately found that Eisler's deliberate miscalculation of the settlement prices falsely inflated the value of First West's account by, on average, approximately $2 million each day. *Matter of Norman Eisler*, 2004 WL 77924 at *4; *see also id.* at *6. The CFTC found that the Exchange unlawfully failed to enforce its own rules in permitting this manipulation to occur, *Matter of New York Futures Exch., Inc.*, CFTC No. 01-13 (C.F.T.C. July 11, 2001), *available at* http://www.cftc.gov/files/enf/01orders/enfnyfe.pdf (last visited Mar. 7, 2007).

Petitioner Klein was First West's futures commission merchant and, as such, entered into and executed the transactions involving the P-Tech futures and was financially liable for the transactions. Petitioner was required by the rules of the Board of Trade and its clearinghouse, as mandated by the CEA, *see* 7 U.S.C. § 7(b)(5), to determine whether First West's account met petitioner's margin requirements by using the settlement prices issued by the Exchange, prices which, unbeknownst to petitioner Klein, were being manipulated by Eisler. Because of the Board of Trade's failure to follow its rules, the margin requirements due by Eisler to petitioner were, on an ongoing basis, insufficient to cover First West's accounts based on an actual unmanipulated, settlement price. Compl. ¶ 61.

Beginning in March 2000, various affiliates, officers, and agents of the respondent Board of Trade and Exchange received, or became aware of, complaints from various floor trading members of the Exchange regarding the miscalculation of P-Tech futures settlement prices. Respondents, in bad faith, never conducted any inquiry into the facts underlying the complaints, however, or placed members of the industry on notice of the possible miscalculation of the settlement prices. Their bad faith failure in these respects violated the CEA, the CFTC's

regulations, and the Board of Trade's own rules. Compl. ¶¶ 64-73.

By May 2000, the P-Tech futures market became too volatile for Eisler to sufficiently manipulate the settlement price. *Matter of Norman Eisler*, 2004 WL 77924 at *12. Thus, despite Eisler's manipulation efforts, on May 11, 2000, the First West account with petitioner was subject to a margin call of approximately $700,000. Neither Eisler nor First West could meet the margin call and petitioner ordered Eisler to liquidate First West's position. Compl. ¶¶ 80-84.

A day later, on May 12, petitioner contacted an executive vice president of the respondent Board of Trade, who was the officer responsible for financial futures for the Board of Trade and the Exchange. Petitioner expressed concern over Eisler's inability to meet his margin call and the illiquidity of the P-Tech futures market and requested that the Board of Trade take emergency action to halt trading in P-Tech futures. No action was taken, and the market for P-Tech futures became illiquid and collapsed. Compl. ¶¶ 89-91.

On May 15, 2000, the Board of Trade suspended the membership of Eisler. In his absence, the Exchange settlement committee recalculated the settlement price, resulting in a surprisingly and grossly divergent settlement price from the previous trading day's settlement price. Under the new settlement price, First West's margin account debit with petitioner ballooned to $4.5 million. Again, neither Eisler nor First West could meet the margin call and petitioner, as the merchant that engaged in the transactions, was required to take a charge against its net capital in the amount of Eisler's margin call deficiency. The capital charge put petitioner below the CFTC's and the Board of Trade's minimum regulatory requirements and, thus, out of business. Compl. ¶¶ 99-107.

b. Petitioner brought the instant action on July 26, 2000, in the United States District Court for the Southern District of New York against Eisler, First West, and the several respondents, alleging violations of, *inter alia*, the Commodity Exchange Act, 7 U.S.C. § 25(b)(1).[5]

The district court dismissed the case, holding that petitioner lacked standing. App., *infra*, 24a. The court failed to acknowledge that the different rights of action under 7 U.S.C. § 25(a)(1) and under 7 U.S.C. § 25(b)(1) have different standing requirements. Instead, the court applied the standing requirements of Section 25(a)(1) to Section 25(b)(1) as well, incorrectly declaring generally that "Section 22 of the CEA requires that a plaintiff stand in at least one of four possible relationships with defendant" codified at 7 U.S.C. § 25(a)(1)(A) through (D). App., *infra*, 23a.

The district court further held that petitioner failed to meet the requirement of Section 25(b)(1) that it be a person "who 'engaged in any transaction on or subject to the rules' of such contract markets or licensed boards of trade." App., *infra*, 23a. The court ruled that petitioner could not meet that requirement because, in the court's view, petitioner was not a purchaser or a seller of P-Tech futures and "did not suffer its damages in the course of its trading activities on a contract market." App., *infra*, 25a.[6]

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[5] Petitioner also sued under 7 U.S.C. § 25(a)(1) and brought actions under 7 U.S.C. § 25(b)(3) against the individual respondents, Mark D. Fichtel; Albert Weis; Jeff Soman; Charles Sweeney; Al Peres; Chris Meek; George Haase; Lawrence Gulitti; Bryan Ssyler; Nitesh Trivedi; Joseph O'Neill; Walter Fair; Evan Thomas; and Joseph Jach, but petitioner does not seek review of the court of appeals' ruling as to those defendants. Klein did not appeal the dismissal of his complaint against Eisler and First West.

[6] Klein also alleged that respondents' conduct gave rise to state common law causes of action. The district court exercised its discretion to dismiss those claims without prejudice pursuant to 28 U.S.C. § 1367(c), once it dismissed the federal claims. App., *infra*, 26-27a. The

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c. The court of appeals affirmed. App., *infra*, 2a. The court acknowledged that Congress created different private rights of action under 7 U.S.C. § 25. The court explained that Section 25(a) "relates to claims against persons other than registered entities and registered futures associations," whereas Section 25(b) "deals with claims against those entities and their officers, directors, governors, committee members and employees." App., *infra*, 7a. But the court ignored the explicit textual differences regarding standing under the two different rights of action and held that all the rights of action, including under Section 25(b)(1), are limited to the four categories of persons described in Section 25(a)(1)(A) through (D).

The court of appeals denied a petition for rehearing and rehearing *en banc* on November 14, 2006. App., *infra*, 35a-36a.

This petition seeks review of the court of appeals' clearly erroneous statutory construction, which is based on a view that futures commission merchants do not engage in transactions on, or subject to the rules of, a board of trade, and which conflicts with the conclusions of other circuits.

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court of appeals affirmed that exercise of discretion in light of an appeal by respondents that the district court should have dismissed the state law claims with prejudice because they were preempted by the CEA. *Id.* at 13a-15a. That portion of the lower courts' opinion is not the subject of this petition.

## REASONS FOR GRANTING THE PETITION

### THE COURT OF APPEALS' RULING DISRUPTS THE COMMODITY EXCHANGE ACT'S CAREFULLY CRAFTED FRAMEWORK OF EXPRESS PRIVATE RIGHTS OF ACTION THAT PROTECT AGAINST MARKET MANIPULATION IN A CRITICAL SEGMENT OF THE NATIONAL ECONOMY

The decision below rests upon an obvious and fundamental misreading of the Commodity Exchange Act (CEA) and conflicts with the decisions of other courts and the pertinent administrative agency.

The issues presented here are of substantial importance to the futures markets and the economy of the United States because the court of appeals' ruling will have significant adverse consequences for an industry that involves trading worth hundreds of billions of dollars annually. The Commodity Futures Trading Commission (CFTC), which regulates the national futures market, has recognized that the underlying dispute between petitioner and respondents is of great significance to the markets.

The court of appeals denied to futures commission merchants the express right of action conferred by Congress to recover actual losses suffered as a result of the bad faith failure of a board of trade to enforce the statute, bylaws, rules, regulations or resolutions that it is required to enforce by law. Directly contrary to the plain language of the statute, the court of appeals inexplicably grafted standing requirements from one right of action onto a different right of action. Moreover, the court of appeals erred in broadly concluding that futures commission merchants do not meet the statutory requirement of having "engaged in [a] transaction on" or "subject to the rules of" a board of trade despite the statutory requirement that such merchants enter into and execute the transactions and bear financial liability for them. *Nagel v. ADM Investor Servs., Inc.*, 217 F.3d 436, 439 (7th Cir. 2000).

Indeed, Congress enacted the Commodity Exchange Act specifically to require that futures contracts be subject to such rules and to regulate such transactions, 7 U.S.C. § 6(a), which unquestionably include the nearly two billion transactions in which futures commission merchants such as petitioner engage each year.

The ruling below by the Second Circuit conflicts with the longstanding decisions of the Seventh Circuit, the other jurisdiction in which commodity exchanges are concentrated, as well as decisions of other circuits and administrative adjudications of the Commodity Futures Trading Commission (CFTC). Those other courts plainly recognize that futures commission merchants engage in commodity futures transactions and, moreover, are indispensable principals in *every* futures contract. *See, e.g.*, *Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179, 181 (7th Cir. 1984).

## A. The Ruling Below Will Have A Profoundly Adverse Effect On The Futures Industry, A Critical Segment Of The National Economy

The ruling below is fraught with error and yields a result with grave implications for the national economy.

1. The futures industry is a critical driving force behind the economy of the United States and the world. The success of the futures industry and its positive effect is reflected by the shear volume and breadth of transactions that occur annually. In 2005, a staggering 1.55 billion futures contracts were traded in the United States. *See* CFTC, *Futures Statistics by Major Commodity Group, All Markets Combined for FY 1999 – FY 2005*, at 1 *available at* http://www.cftc.gov/files/dea/dmostat_fy05.pdf (last visited Mar. 7, 2007). And, according to the CFTC, over $110 billion is currently invested in the futures markets of the United States. *See* CFTC, *Selected FCM Financial Data as of November 30, 2006*, at 6, *available*

*at* http://www.cftc.gov/files/tm/fcm/tmfcmdata0611.pdf (last visited Mar. 7, 2007).

Accordingly, it should come as little surprise that the federal government recognizes that boards of trade "are not just typical commercial enterprises, but are commercial enterprises affected with a significant national public interest. Actions that distort prices or otherwise undermine the integrity of the futures markets have broad, detrimental implications for the economy as a whole and the public in general." CFTC, *Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations*, 72 Fed. Reg. 6936, 6938 (Feb. 14, 2007) (to be codified at 17 C.F.R. pt. 38). Futures markets "provide an important hedging vehicle to individuals and firms in a myriad of industries, resulting in more efficient production, lower cost for consumers, and other economic benefits." *Ibid.*; *see also* 7 U.S.C. § 5(a) (finding that "[t]he transactions subject to this Act * * * are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.").

The futures industry thus serves as a critical means for vital sectors of the economy – from agriculture to manufacturing – to protect themselves, through hedging, from unpredictable price shifts. *See Merrill Lynch*, 456 U.S. at 359 ("A farmer who takes a 'short' position in the futures market is protected against a price decline; a processor who takes a 'long' position is protected against a price increase."). "Such 'hedging' is facilitated by the availability of speculators willing to assume the market risk that the hedging farmer or processor wants to avoid. The speculators' participation in the market substantially enlarges the number of potential buyers and sellers of executory contracts and therefore makes it easier for farmers and processors to make firm commitments for future delivery at a fixed price." *Ibid.*

2. The decision below will disrupt this important segment of the United States economy. If not corrected, the Second Circuit's holding will mean that many who need to hedge against price fluctuations will find the necessary transactions more expensive or so thinly traded as to not provide an accurate indication of the actual value of the underlying commodity.

Under the court of appeals' decision, the futures commission merchants that engage in the 1.5 billion futures transactions annually and bear the ultimate risk of loss in such transactions, are denied their federal cause of action to seek legal redress against a board of trade or clearinghouse that violates in bad faith the laws put in place by Congress to prevent against price manipulation. The ruling thereby shifts market risk onto futures commission merchants away from the very self-regulating entities – the boards of trade and clearinghouses – who have control over enforcement of the rules that prohibit the misconduct that creates this market risk.

Because the ruling below makes commodity exchanges unaccountable to futures commission merchants for bad faith violations of law, merchants will likely mitigate their risk of exposure to losses on such markets. Either of the two primary methods for merchants to accomplish this goal will make the markets less efficient. First, merchants may refuse to participate in riskier markets. That will make those markets more inelastic and reduce the ability of investors to hedge volatile positions. *See Baker v. Edward D. Jones & Co.*, CFTC No. R 76-4, 1981 WL 26078, at *3-4 (C.F.T.C. Jan. 27, 1981). As these risky markets become more inelastic (and more costly in which to transact), hedging investors will lose valuable means of protecting themselves from price fluctuations, which will distort the actual prices for the underlying commodities and make those futures more prone to price manipulation. Farmers and manufacturers in these risky markets will be

forced to pay a premium to hedge against price declines and price increases.

Second, futures commission merchants may mitigate their increased exposure to economic loss stemming from the decision below by demanding higher margins from all or some investors. This approach will make trading more costly, which will make the futures markets as a whole less liquid, particularly if market participants exit certain market segments. *Cf. United States v. Dial*, 757 F.2d 163, 169 (7th Cir.) ("Trading without margin also shifts the risk from the trader to the broker, * * * which would have had to make good on any losses."), *cert. denied*, 474 U.S. 838 (1985). Even minor increases in margins, particularly in more risky segments of the market, will unquestionably affect prices.

This concern is not idle speculation. The instant dispute has garnered substantial attention from many components of the commodities futures industry. For example, the Futures Industry Association, Inc., which has as its members most of the industry's futures commission merchants as well as the exchanges that are subject to suit (*including* respondents Board of Trade and its clearinghouse),[7] has argued that its "clearing firm

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[7] Both respondents Board of Trade and New York Clearing Corporation are associate members of the Futures Industry Association, Inc. *See* www.futuresindustry.org/memberfi-2147.asp (last visited Mar. 7, 2007). The Futures Industry Association, Inc.'s "clearing firm members handle at least 90% of the customer business on U.S. futures exchanges." C.A. Motion of Futures Industry Association, Inc. For Leave To File Brief As *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc* Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir. 2006) at 2.

Notwithstanding this broad coalition of members who face potential liability, the Futures Industry Association, Inc. has unequivocally asserted that the decision below is wrong and needs to be reversed. *See* Brief of Futures Industry Association Inc. as *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc*

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members [*i.e.*, futures commission merchants] and the futures industry as a whole [will] be harmed significantly" by the court of appeals' ruling in this case because that ruling "nullifies an important statutory remedy for the bad faith breach of legal duties by self-regulatory organizations for the futures markets." C.A. Motion of Futures Industry Association, Inc. For Leave To File Brief As *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc* Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir.) at 2.[8]

Indeed, as a result of this underlying dispute, the federal government reevaluated the market risk facing merchants and their customers. Immediately following petitioner's failure, but before the full extent of the underlying unlawful market manipulation was brought to light, the CFTC investigated the incident to prevent recurrences. The government counseled that merchants should find ways to acceptably manage risks. But the CFTC also cautioned that "[m]argin is not designed to cover all possible losses, because if margin levels were set high enough to do so, the products would not be economically viable," CFTC, *Report on Lessons Learned from the Failure of Klein & Co. Futures, Inc.* at 3 (July 2001), which is a plain acknowledgment by the federal government that total mitigation of risk by merchants can and will adversely affect the futures market. Accordingly,

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Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir. 2006) at 8.

[8] *See also* C.A. Motion of Futures Industry Association, Inc. For Leave To File Brief As *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc* Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir. 2006) at 3-4 (faced with the denial of their right of action under Section 25(b)(1) "some firms could reasonably decide to reduce their capital exposure in futures clearing systems. If they do, futures markets would become less liquid causing exchange trading to become more costly and even diverting trades to less transparent (and less regulated) over-the-counter markets.").

the CFTC primarily advocated that contract markets engage in greater merchant oversight, *see id.* at 13-16, 18-19, a result which does nothing to protect merchants from the sort of contract market malfeasance that was subsequently revealed in this case. *See Matter of Norman Eisler*, 2004 WL 77924 at *2. Private enforcement of the CEA for bad faith contract market rule violations thus provides the only means for merchants to protect their financial interests without distorting the futures markets.

The decision below comes at a particularly inopportune time for the futures industry. The CFTC has found it increasingly difficult for boards of trade to maintain adequate self-regulation in the face of increased conflicts of interest. As the CFTC has explained, when boards of trade "were first entrusted with * * * extensive regulatory responsibilities, they were almost exclusively member-owned, not-for-profit exchanges facing little competition for customers or in their prominent contracts." 72 Fed. Reg. at 6938. Today, that is no longer the case and boards of trade

> now face potential conflicts of interest between their critical self-regulatory responsibilities and their powerful commercial imperatives. Specifically, [boards of trade] must: defend and expand their markets against others offering similar products or services; generate returns for their owners; and provide liquid markets where their members and customers may profit. At the same time, they must continue to meet fundamental public interest responsibilities through vigorous and impartial self-regulation.

*Ibid.*

The CFTC's immediate investigation into petitioner's failure due to respondents' illegal actions and the broad industry support for petitioner are clear indications of the importance of this case. The federal government's concern over the underlying dispute and attendant issues reflected

in the CFTC's report, its administrative actions against Eisler and the Exchange, and its issuance of new rules to eliminate contract market conflicts of interest, also demonstrate a substantial interest of the United States in this case.

## B. The Court Of Appeals Plainly Misread The Scope Of The Statutory Private Right Of Action And Misconstrued The Critical Role Played By Futures Commission Merchants, Contrary To The Decisions Of Other Circuits And The Commodity Futures Trading Commission

The decision below is premised upon a fundamental misreading of the Commodity Exchange Act because the court of appeals adopted a narrow interpretation of the statutory language, "transactions on" or "subject to the rules of" a board of trade, which would render the Act internally inconsistent and lead to absurd results.

### 1. The ruling below stands in irreconcilable conflict with the language of Section 6(a)(1), that futures commission merchants can lawfully conduct business only so long as they enter into or execute transactions on, or subject to the rules of, a board of trade

Congress made clear in the CEA that futures commission merchants must conduct their business by engaging in transactions on, or subject to the rules of, a board of trade. This requirement is an important consumer protection provision that ensures that merchants abide by the rules that Congress requires in order to protect against market manipulation. A transaction that is not subject to such rules is unlawful.

Congress specified that it is:

> unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting, or accepting any order for, or otherwise dealing in, *any transaction in, or in connection with*, a contract for the purchase or sale of a commodity for future delivery * * * unless –
>
> (1) *such transaction is conducted on or subject to the rules of* a board of trade which has been designated or registered by the Commission as a contract market * * *.

7 U.S.C. § 6(a)(1) (emphasis supplied).[9]

Moreover, Congress defined futures commission merchants as the entities that solicit or accept orders for futures subject to the rules of a board of trade, 7 U.S.C. § 1a(20)(A), and authorized such merchants to accept "money, securit[y], or property" or to extend credit "to margin, guarantee, or secure" any trades or contracts that result from such orders. 7 U.S.C. § 1a(20)(B). Congress expressly authorized boards of trade to establish rules to authorize futures commission merchants "to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization." 7 U.S.C. § 7(b)(3)(C).

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[9] Transactions which do not fall within 7 U.S.C. § 6(a) are outside the scope of the CEA. *Lachmund v. ADM Investor Servs., Inc.*, 191 F.3d 777, 786 (7th Cir. 1999).

The ruling below ignores this statutory framework. In direct conflict with the clear import of those statutory provisions, the court below held that future commission merchants do not "engage in any transaction on," or "subject to the rules of," a board of trade, which, of course, is the statutory requirement for the private right of action under 7 U.S.C. § 25(b)(1) at issue in this case. According to the court below, petitioner was not engaged in a transaction on, or subject to the rules of, a board of trade because it did not trade or own the contracts at issue, *see* App., *infra*, 11a, and acted only as a guarantor of the underlying transaction, *see* App., *infra*, 12a. The court thus viewed a futures commission merchant as an entity which financially facilitates, but is ultimately unnecessary to, futures transactions.

But the view of the court below cannot be correct because 7 U.S.C. § 6(a)(1) provides that a futures commission merchant *must* engage in such transactions to lawfully participate in the market, as they do nearly two billion times annually. Under the court of appeals' rationale, all futures commission merchants' transactions in connection with "a contract for the purchase or sale of a commodity for future delivery" would be unlawful because the transactions would not be "on or subject to the rules of a board of trade." 7 U.S.C. § 6(a). Clearly, Congress did not intend or contemplate such an interpretation.

### 2. The ruling below conflicts with decisions of other circuits and the CFTC that correctly interpret the role of futures commission merchants as critical principals who engage in transactions on, and subject to the rules of, the boards of trade

Not surprisingly, the narrow construction by the court below of the role of futures commission merchants in the

futures industry plainly conflicts with the longstanding interpretation of the CEA by other circuits and the CFTC. Those other jurisdictions recognize that the merchants engage in the trades on the exchange as buffering intermediaries between the investors and exchanges. The contrary view of the court of appeals in this case on the role of future commission merchants in the statutory framework creates a conflict of greater importance than is typical because it involves the two courts of appeals with jurisdiction over cases arising out of Illinois and New York, where the nation's most significant commodity exchanges are located and thus where most CEA actions are filed.[10]

a. The Seventh Circuit correctly understands that futures commission merchants must engage in futures transactions on, or subject to the rules of, a board of trade in order for the trades to be lawful. *See Nagel*, 217 F.3d at 439 ("The Commodity Exchange Act requires that futures contracts be sold through commodity exchanges and the futures commission merchants registered on those exchanges, 7 U.S.C. § 6(a) * * *. The section just cited declares futures contracts not sold through commodity exchanges *and registered futures commission merchants* unlawful.") (emphasis supplied, internal citation omitted).

Moreover, the Seventh Circuit repeatedly has recognized that clearing member futures commission merchants are the key intermediaries between contract markets and individual investors. Because Congress provided that an individual investor *cannot* directly engage in a transaction with an exchange, "the contract of sale is actually between

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[10] The largest U.S. exchanges are the Chicago Mercantile Exchange, Chicago Board of Trade, Chicago Board Options Exchange, NYBOT, and New York Mercantile Exchange (NYMEX). NYMEX is physically the largest commodity futures exchange in the World. *See* NYMEX, Who We Are, available at http://www.nymex.com/intro.aspx (last visited Mar. 7, 2007).

the floor trader's clearing member * * *, and the buyer's clearing member." *Bernstein*, 738 F.2d at 181. Those clearing members are the futures commission merchants. As such, it is the futures commission merchant that actually suffers any loss, because it "will have to *honor* the contract whatever the price." *Ibid.* (emphasis supplied).

The fallacy of the contrary decision by the court below in the instant case is underscored in *Bosco v. Serhant*, 836 F.2d 271 (7th Cir. 1987), *cert. denied*, 486 U.S. 1056 (1988), where the Seventh Circuit correctly recognized that a futures transaction cannot occur without the "services of both a clearing member of the Exchange * * * and a futures commission merchant * * *," *id.* at 273, which in the instant case were both provided by petitioner.

Other circuits agree with the Seventh Circuit that it is the futures commission merchants that actually engage in the transactions. *See Bibbo v. Dean Witter Reynolds, Inc.*, 151 F.3d 559, 560 (6th Cir. 1998) ("Futures trades are executed on a customer's behalf *by an FCM*.") (emphasis supplied). *Scott v. Prudential Sec., Inc.*, 141 F.3d 1007, 1013 n.10 (11th Cir. 1998) ("The Commodity Exchange Act regulates those who participate in transactions involving commodity futures. Persons who actively participate in that industry, including futures commissions merchants, * * * must register under the CEA.") (internal citation omitted), *cert. denied*, 525 U.S. 1068 (1999). *Cf. Merrill Lynch*, 456 U.S. at 359-360 ("[T]here are the futures commission merchants, the floor brokers, and the persons who manage the market; they also are essential participants, and they have an interest in maximizing the activity on the exchange.").

b. The decision below is also inconsistent with the CFTC's understanding of the necessary services provided by futures commission merchants (abbreviated by the CFTC as FCM) in futures transactions. Like the Seventh Circuit, the CFTC, in administrative adjudications, has recognized that "[a]n FCM * * * occupies a unique position

in the scheme of futures regulation. * * * [A]n FCM is the one who actually trades futures for the investing public * * * [and] carries out its daily routine through the instrumentalities of the national futures exchanges." *In the Matter of W. Fin. Mgmt.*, CFTC No. 81-18, 1983 WL 29657 at *11 (C.F.T.C. Oct. 14, 1983).

For the reasons discussed above, whether merchants engage in transactions on, or subject to the rules of, a contract market is a significant issue that is inextricably tied to the CEA's scope and directly affects who is vested with a private right of action under 7 U.S.C. § 25(b)(1) to deter statutory, regulatory, and rules violations by boards of trade.

### C. The Decision Below Fails To Give Meaning To Congress's Express Inclusion Of Certain Standing Requirements In One Right Of Action But Not In Another

The Second Circuit compounded its erroneous interpretation of the statutory text in this case by ignoring one of the most basic canons of statutory construction: "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23 (1983) (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)); *see also Lopez v. Gonzales*, 127 S. Ct. 625, 631 (2006); *Barnhart v. Sigmon Coal Co., Inc.*, 534 U.S. 438, 454 (2002); *INS v. Cardoza-Fonseca*, 480 U.S. 421, 431 (1987).

The court of appeals concluded that petitioner's action under 7 U.S.C. § 25(b)(1) against the Board of Trade could not go forward because petitioner does not fall within any of the four categories of persons described in 7 U.S.C. § 25(a)(1)(A) through (D). App., *infra*, 9a. But Section

25(b)(1) includes no such requirement or even mention of those subdivisions. It is only Section 25(a)(1) and other subparagraphs of Section 25(b), all of which involve actions against different types of defendants, that limit the rights of action to the four categories of persons described in Section 25(a)(1)(A) through (D), not Section 25(b)(1) actions against boards of trade.

Section 25(b)(1) expressly vests a private right of action in a person who engaged in "any" transaction on, or subject to the rules of, a board of trade. That stands in contrast to the text of Sections 25(b)(2) and (3) which provide for suits against registered futures associations and certain employees of registered futures associations and boards of trade. 7 U.S.C. § 25(b)(2), (3). Unlike Section 25(b)(1), these other two sections do not have such an expansive provision regarding what persons may bring suit. Rather, the texts of Sections 25(b)(2) and (3) limit the right of action to persons who engaged in a "transaction specified in subsection (a)," *i.e.*, Section 25(a)(1)(A)-(D). *Ibid.* That makes sense because Congress would want to provide more expansive liability under Section 25(b)(1) for the entities which are the most responsible – boards of trade and their clearinghouses – for protecting the transparency of the market. As such, by subjecting a board of trade or clearinghouse to liability for actual losses arising from any transaction due to their bad faith failure to enforce the CEA, the CFTC's regulations, and their own rules that prohibit market manipulation, Congress ensured that those entities will have a substantial incentive to comply with those provisions.

Accordingly, the court of appeals was wholly unjustified in holding that it was merely congressional inadvertence when Congress decided *not* to incorporate the requirements for a right of action against brokers, merchants and advisors under Section 25(a)(1)(A) through (D) into the right of action against contract markets under Section 25(b)(1). *See Russello*, 464 U.S. at 23 (counseling against assuming that such differences are "a simple mistake in draftsmanship").

The court of appeals' error here is all the more egregious in light of the fact that this Court previously has analyzed the same statutory construction doctrine in the context of this very statute. In *Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co.*, 484 U.S. 97 (1987), this Court held that Congress's omission of a provision in 7 U.S.C. § 25 that exists elsewhere in the CEA does not implicitly incorporate that provision into Section 25. Accordingly, in addressing whether the nationwide service of process provisions set forth in 7 U.S.C. § 13a-1(e) for actions to enjoin or restrain violations also apply to private rights of action brought under Section 25, this Court held that the silence in Section 25 on service of process

> contrasts sharply with the other enforcement provisions of the CEA * * *. We find it significant that Congress expressly provided for nationwide service of process in those sections but did not do so in the new [7 U.S.C. § 25]. It would appear that Congress knows how to authorize nationwide service of process when it wants to provide for it. That Congress failed to do so here argues forcefully that such authorization was not its intention.

484 U.S. at 106 (internal citation omitted).

### D. The Second Circuit's Ruling Is Contrary To Congress's Important Purpose In Creating The Section 25(b)(1) Private Right Of Action

The legislative background and purpose of the private rights of action under 7 U.S.C. § 25 further demonstrate that Congress conferred on futures commission merchants a private right of action against a board of trade for actual losses due to bad faith misconduct by the board. The House Conference Report explains that "the amendment [authorizing a private right of action] essentially would authorize private rights of action *by market participants*

*but not by members of the public who did not particulate in the market* and claimed to be injured in their commercial transactions by declines in commodity prices." H.R. Rep. No. 565, Part I, 97th Cong., 2d Sess. 57 (1982). Accordingly, Congress made a reasoned judgment to allow those who directly engage in transactions on commodity exchanges to sue the board of trade for bad faith conduct that causes actual losses.

Thus, contrary to the ruling below, the Seventh Circuit correctly has recognized that the principal distinction between those who have statutory standing under Section 25(b)(1) and those who do not, is whether the putative plaintiffs actually participated in the market instead of having merely been affected by it. In *American Agriculture Movement Inc. v. Board of Trade*, 977 F.2d 1147 (7th Cir. 1992), that court held that the plaintiffs – an association of soybean farmers who lost money when the price of their crops declined due to fluctuations on the contract market – lacked standing under 7 U.S.C. § 25(b)(1) against the contract markets because their suit was "for speculative damages to assets that are affected by fluctuations in prices on the commodity market but which are not the subject of transactions on such market." *Id.* at 1153 (quoting H.R. Rep. No. 565, Part I, 97th Cong., 2d Sess. 57 (1982)). As such, non-traders, including the farmers and their associations, are "foreclose[d]" from any remedies under Section 25(b)(1) because they did not participate in the futures market, *ibid.*, an impediment that does not apply to merchants such as petitioner. *Bernstein*, 738 F.3d at 181 ("the contract of sale is actually between the floor trader's clearing member * * *, and the buyer's clearing member").

In sum, the ruling below defeats the express intent of Congress that private rights of actions under the CEA serve to help prevent manipulation of the market. As discussed above, futures commission merchants are the entities with the institutional interest and means for bringing actions against a board of trade for bad faith

violations of the CEA, CFTC regulations, and board rules because the merchants are the ones who bear the economic loss of such misconduct. There is no indication in the statutory text or history that Congress somehow intended to carve them out of the rights of action it created, and it would make no sense for Congress to have done so in light of the purpose of the statute.

## CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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MARCH 14, 2007

# APPENDIX A

464 F.3d 255

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

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August Term, 2005

(Argued: February 3, 2006 Decided: September 18, 2006)

Docket Nos. 05-1374-cv(L), 05-1662-cv(XAP),
05-1702-cv(XAP), 05-1718-cv(XAP)

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KLEIN & CO. FUTURES, INC.,

*Plaintiff-Appellant-Cross-Appellee*,

–v.–

BOARD OF TRADE OF THE CITY OF NEW YORK, NEW YORK CLEARING CORPORATION, MARK D. FICHTEL, ALBERT WEIS, JEFF SOMAN, CHARLES SWEENEY, AL PERES, CHRIS MEEK, GEORGE HAASE, LAWRENCE GULITTI, BRYAN SAYLER, HITESH TRIVEDI, NEW YORK COTTON EXCHANGE, INC., NEW YORK FUTURES EXCHANGE, INC., JOSEPH O'NEILL, WALTER FAIR, EVAN THOMAS, JOSEPH JACH,

*Defendants-Appellees-Cross-Appellants*,

FIRST WEST TRADING, INC., AND NORMAN EISLER

*Defendants-Cross-Appellants*,

JOHN DOE 1-10, RICHARD ROE AND PETER POE,

*Defendants.*

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Before:

POOLER AND B.D. PARKER*,

*Circuit Judges.*

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Plaintiff-Appellant Klein & Co. Futures, Inc., appeals the dismissal by the United States District Court for the Southern District of New York (Daniels, *J.*) for lack of standing to bring claims under Sections 22(a) and (b) of the Commodity Exchange Act (CEA), 7 U.S.C. § 25. We affirm.

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JEFFREY PLOTKIN, Pitney Hardin LLP, New York, NY, *for Appellant Klein & Co. Futures, Inc.*

GARY D. STUMPP, Stumpp & Bond LLP, New York, NY, *for Appellees First West Trading, Inc. and Norman Eisler.*

HOWARD R. HAWKINS, JR., Cadwalder, Wickerhsam & Taft LLP, New York, NY, *for Appellees NYBOT, et al.*

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B.D. PARKER, Circuit Judge:

Klein & Co. Futures Inc. is a futures commission merchant ("FCM") and a clearing member of New York Clearing Corporation ("NYCC"). Klein appeals the dismissal

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* The Honorable Denny Chin of the United States District Court for the Southern District of New York was originally assigned to sit by designation on this panel but recused himself before oral argument. This case is decided by the two remaining members of the panel pursuant to Section 0.14(b) of the Local Rules.

by the United States District Court for the Southern District of New York (Daniels, *J.*) for lack of standing to bring claims against Defendant-Appellees the Board of Trade of the City of New York ("NYBOT"), New York Clearing Corporation ("NYCC"), Norman Eisler, and others (collectively "NYBOT Defendants") under Sections 22(a) and (b) of the Commodity Exchange Act (CEA), 7 U.S.C. § 25. After dismissing Klein's claims under the CEA, the district court declined to exercise jurisdiction over its supplemental state law claims and dismissed them without prejudice. The NYBOT defendants cross-appeal that dismissal. For the reasons set forth below, we affirm. Except as noted, the facts are drawn from the complaint.

As a FCM, Klein facilitated the trading and fulfilled certain obligations of its customers who traded through the NYBOT. Prior to May 2000, Defendant Norman Eisler, whose conduct is the focus of Klein's complaint, was the Chairman of the New York Futures Exchange ("NYFE"). The NYFE is a futures and options exchange designated by the Commodity Futures Trading Commission ("CFTC") as a contract market for the trading of commodities futures and options, including P-Tech Futures and Options ("P-Tech contracts"). Eisler was also a member of the NYFE's Settlement Committee for the Pacific Stock Exchange Technology Index Futures Contract & Options (the "Committee"). The Committee's primary responsibility was to calculate the price of P-Tech contracts for the purposes, among other things, of calculating margin requirements in customers' accounts.[1] Eisler was also a

[1] P-Tech Futures and Options prices are based on a composite index of one hundred technology stocks compiled by the Pacific Stock Exchange. The prices of those stocks and the value of that index may

(Continued on following page)

customer of Klein and the principal of First West Trading Inc. ("First West"), another Klein customer. Eisler traded in P-Tech contracts for the account of First West. The trades were unsolicited and were made without input or advice from Klein.

Allegedly, Eisler, in his capacity as a member of the Committee, secretly manipulated the settlement prices of P-Tech contracts.[2] This manipulation benefitted Eisler's P-Tech positions but, at the same time, caused Klein to miscalculate the margin requirements for the First West account. Around March 2000, the NYBOT began receiving complaints regarding the P-Tech settlement prices but failed to make proper inquiries or to place Klein or other members of the industry or public on notice of potential irregularities.

In early May 2000, Klein, based on the incorrect settlement prices, computed the required margin in First West's account at $700,000, but Eisler was unable to post that amount. Klein then contacted the NYBOT and expressed concerns regarding the illiquidity of the P-Tech contracts, Eisler's inability to meet First West's margin call, and his inability to liquidate First West's contracts. Klein reported that the First West margin deficit, if not

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change up to the close of trading. Therefore, the Committee was charged with setting the settlement price after the close of the market.

[2] On July 11, 2001, the CFTC filed a complaint against Eisler and First West charging them with manipulation and making false reports under the CEA and CFTC regulations. The CFTC's order, entered with the consent of Eisler and First West but without their admitting or denying the findings, requires them to pay a civil penalty of up to $4,923,000 for violating provisions of the CEA and regulations alleged in the complaint. *In re Eisler,* CFTC Docket No. 01-14, 2004 WL 77924 (CFTC Jan. 20, 2004).

covered, would impair Klein's net capital and cause Eisler significant losses. Klein requested that the NYFE Board halt trading in P-Tech contracts, but no such action occurred.

At that point, the scheme began to unravel. In mid-May, Eisler's NYBOT membership privileges were suspended and he was dropped from the Committee. Once this occurred, the remaining Committee members recalculated the settlement prices and First West's margin deficit ballooned to $4.5 million, an obligation it could not meet. As a result, Klein was required to take an immediate charge against its net capital, forcing it below the minimum required for clearing members of the NYCC and the New York Mercantile Exchange ("NYMEX"). Its membership privileges were suspended and Klein collapsed.

Klein then sued on various claims. Klein's first claim alleged that NYFE violated § 5b of the CEA by failing to enforce its rules, and sought a declaration that NYFE should be suspended as a contract market. Klein further alleged that the NYBOT Defendants violated the anti-fraud provisions in CEA § 4b and 17 C.F.R §§ 33.9 and 33. 10, and the insider provisions of CEA § 9. In addition, the complaint alleged a variety of state law claims.

The NYBOT Defendants moved to dismiss principally on the ground that Klein was not a purchaser or seller of futures contracts or options and, therefore, lacked standing under § 22 of the CEA. They also they [sic] moved to dismiss Klein's state law claims with prejudice on the ground that they were preempted by the CEA. The district court agreed and dismissed Klein's claims under

the CEA for lack of standing. Specifically, the district court concluded:

> Plaintiff Klein lacks standing under Section 22 to bring this suit. Klein does not allege that it was either a purchaser or a seller of P-Tech Futures and Options. Furthermore, Klein does not claim that it traded for its own account. Rather, it is undisputed that *First West,* not Klein, traded in P-Tech Futures and Options. Indeed, Klein claims that these trades were effected "without input, counsel, advice or any type of recommendation whatsoever from Klein & Co." Klein further alleges that it "had no equity or financial interest in the First West account nor did Klein & Co. exercise control over the trade in said account."

*Klein & Co. Futures. v. Bd. of Trade,* No. 00-CV-5563-GBD, 2005 WL 427713, at *4 (S.D.N.Y. Feb. 18, 2005 (internal citations omitted)).

The court further reasoned that § 22 precluded an action by a plaintiff that "did not suffer its damages in the course of its trading activities on a contract market." *Id.* Without addressing preemption, the district court declined to exercise supplemental jurisdiction over the state law claims and dismissed them without prejudice. This appeal followed.

## II. DISCUSSION

We review *de novo* the district court's dismissal of a complaint for lack of standing under Fed. R. Civ. P. 12(b)(1) and 12(b)(6). *See Kaliski v. Bacot (In re Bank of N.Y. Deriv. Litig.),* 320 F.3d 291, 297 (2d Cir. 2003). We review the court's decision to decline supplemental jurisdiction over state law claims for abuse of discretion.

*See Valencia ex rel Franco v. Lee,* 316 F.3d 299, 304 (2d Cir. 2003).

## A. Standing under § 22 of the CEA

CEA § 22 enumerates the only circumstances under which a private litigant may assert a private right of action for violations of the CEA. Section 22 includes two types of claims. Section 22(a) relates to claims against persons other than registered entities and registered futures associations. 7 U.S.C. § 25(a).[3] Section 22(b) deals with claims against those entities and their officers directors, governors, committee members and employees. The text of the two subdivisions requires that a putative

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[3] Section 22(a) provides that proper plaintiffs are parties:

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an o r d er for the purchase or sale of –

(i) an option subject to section 4c of this Act (other than an option purchased or sold on a registered entity or other board of trade);

(ii) a contract subject to section 19 of this Act; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract. CEA § 22(a); 7 U.S.C. § 25(a)(1).

plaintiff fall within one of the four required relationships set forth in § 22(a)(1)(A-D).

The common thread of these four subdivisions is that they limit claims to those of a plaintiff who actually traded in the commodities market. Specifically, the remedies afforded by CEA § 22(b) are available only to a private litigant "who engaged in . . . transaction[s] on or subject to the rules of" a contract market. *Id.* § 25(b)(1)-(3).[4] The

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[4] Section 22(b) reads, in relevant part:

(1)(A) A registered entity that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by sections 5 through 5c, (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation or resolution that it is required to enforce by the Commission, or (C) any registered entity that in enforcing any such bylaw, rule, regulation, or order, shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such registered entity to the extent of such person's actual losses that resulted from such transaction. . . .

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a registered entity or registered futures association willfully aids, abets, counsels, induces, or procures any failure by such entity to enforce . . . any bylaw, rule, regulation, or resolution referred to in paragraph (1) . . . , shall be liable for actual damages sustained by a person who engaged in any transaction. . . .

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this Act available to any person who sustains a loss as a result of (A) the alleged failure by a registered entity or registered futures association or by any officer, director, . . . or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph 1 or 2 of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution . . . that is alleged to have violated this Act, or any

(Continued on following page)

section contains another important limitation. Subsection 22(b)(5) provides that the private rights of action against the exchanges enumerated in § 22(b) "*shall be the exclusive remedy* . . . available to *any person* who sustains a loss as a result of" a violation of the CEA or an exchange rule by a contract market or one of its officers or employees. *Id.* § 25(b)(5) (emphasis added).

Klein does not fall within any of the required subdivisions of § 22(a)(1)(A)-(D). To fit under one of the four, Klein must essentially either have (1) received trading advice from Eisler or First West for a fee; (2) traded through Eisler or First West or deposited money in connection with a trade; (3) purchased from or sold to Eisler or First West or placed an order for the purchase or sale through them; or (4) engaged in certain market manipulation activities in connection with the purchase or sale of a commodity contract.

Here, Klein was a FCM and a clearing member of the NYCC that cleared First West's trades through NYCC. Klein does not contend that it purchased or sold P-Tech contracts. Klein was not a trader of P-Tech contracts; nor did it own the P-Tech contracts at issue. To the contrary, Klein's complaint admits that it had no financial interest in the First West account and that all the trades in question were unsolicited by First West. Klein's losses were not the result of its purchases or sales in the commodities market. Klein functioned merely as a broker or agent that earned commissions for handling its customers trades. As a clearing member, Klein cleared

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Commission rule, regulation, or order. CEA § 22(b), 7 U.S.C. § 25(b).

their trades and was obligated to post margins for them as required. Under NYCC Rules governing clearing members, Klein was liable for its own failure to post the required margin on its customers' positions, whether or not Klein collected that margin from defaulting customers such as First West. In view of the provisions of sections 22(a) and (b) expressly limiting the categories of persons that can seek remedies under the statute we conclude, as did the court below, that a plaintiff such as Klein who falls outside those categories lacks standing. *See Water Transp. Ass'n v. ICC,* 722 F.2d 1025, 1028-29 & n.2 (2d Cir. 1983); *see also Am. Agric. Movement Inc. v. Chicago Bd. of Trade,* 977 F.2d 1147, 1153 (7th Cir. 1992) (finding that § 22 of the CEA forecloses remedies on behalf of non-traders), *aff'd in part, rev'd in part on other grounds by Sanner v. Chicago Bd. of Trade,* 62 F.3d 918 (7th Cir. 1995). *Cf. Nicholas v. Saul Stone & Co.,* 224 F.3d 179, 187 (3d Cir. 2000).

Klein's main response to this reading of the statute is that the remedies of § 22 are not limited to those who actually traded and that it has standing because, as the legislative history demonstrates, Congress intended to protect those such as itself who were injured in the course of trading on a contract market. According to Klein, the legislative history shows that Congress's main concern in drafting § 22 was to protect "market participants" who suffered actual losses arising from a transaction on the futures market. Klein contends that Congress intended the restrictions on standing to prevent suits on speculative damages to assets subject to price fluctuations on the commodities markets but which are not the subject of transactions. Affording standing to a FCM, such as Klein, is consistent with these purposes because a FCM that has experienced catastrophic losses, that were caused by a

customer who had engaged in manipulation, has suffered what Congress had in mind: actual, non-speculative damages resulting directly from transactions on a commodities exchange.

This argument founders on the clear text of the statute. Section 22(b)'s remedies are expressly available only to a private litigant who "engaged in any transaction on or subject to the rules" of contract markets or other registered entities. As noted, Klein was not an owner of P-Tech contracts traded by First West. To the contrary, Klein was required by NYCC Rules to keep the options in a segregated First West account and not to co-mingle assets. Klein did not fall within any of the categories enumerated in § 22(a)(1)(A-D). Because we conclude the statute is clear, we decline Klein's invitation to parse the legislative history. *See* 7 U.S.C. § 25(a); *Lee v. Bankers Trust Co.*, 166 F.3d 540, 544 (2d Cir. 1999) ("It is axiomatic that the plain meaning of a statute controls its interpretation and that judicial review must end at the statute's unambiguous terms." (internal citations omitted)).

In the alternative, Klein contends that it has standing under CEA to challenge the NYBOT Defendants as a "forced" purchaser and seller of securities. Klein contends that the Supreme Court in *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975), after confirming that the federal securities laws confer an implied private right of action, granted standing under § 10(b) of the Securities Act of 1934 to securities brokers as "forced" purchasers or sellers, in situations where they, as clearing members, suffered damages arising from obligations to guarantee their customers' trades. Klein argues that as a FCM and clearing member, it was subject to federal statutes as well as the rules and by-laws of NYBOT, NYFE, and NYCC

that required Klein to maintain funds guaranteeing its customers' transactions on the contract market. In his brief on appeal, Klein asserts that it assumed "a very real investment risk that the commodity contracts its customers traded would maintain or increase in value, a risk that is identical to that taken by any purchaser or seller of a commodity contract who is granted standing under the CEA." In sum, Klein argues that it has standing because it faced essentially the same risks as a purchaser or seller of commodities contracts. We disagree.

It is undisputed that Klein was not a trader of P-Tech contracts. Moreover, Klein did not own the P-Tech contracts at issue. Rather, First West, not Klein, traded in P-Tech contracts. Indeed, as the district court recognized, Klein stated in its complaint that it had no financial interest in the First West trading activity and had nothing to do with its trading decisions. Consequently, regardless of whether the First West trading position rose or declined in value, Klein had no interest in any of the resulting profits or investments losses. As the district court observed, "Klein suffered damages because of its customer First West's inability to cover its margin call. . . . " *Klein*, 2005 WL 427713, at *4. Thus, Klein's loss was a credit loss, not a trading loss.

Because § 10(b) and Rule 10(b)(5) are implied causes of action, their "boundaries are left to judicial inference." *Grace v. Rosenstock*, 228 F.3d 40, 46 (2d Cir. 2000). The securities laws discussed in *Blue Chip Stamps* – § 10(b) of the Securities Act of 1934 and Rule 10(b)(5) – contain no corollary to the express limitations on standing expressly imposed by CEA § 22(b). Section 22 was enacted as part of the Futures Trading Act of 1982 in response to *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S.

353 (1982), where the Supreme Court recognized an implied right of action under the CEA. In response, Congress enacted CEA § 22 but enumerated the only circumstances under which a civil litigant could assert a private right of action for a violation of the CEA or CFTA regulations. *See* H.R. Rep. No. 565, Pt. I, 97th Cong., 2d Sess. 57 (1982), reprinted in 1982 U.S.C.C.A.N. 3871, 3906. Congress went on to emphasize that the private right of action in CEA § 22 "shall be the exclusive remedy . . . available to any person who sustains a loss as a result of" a violation of the CEA. 7 U.S.C. § 25(b)(5). Enforcing the statute that Congress wrote, we conclude Klein lacks standing because it was not "engaged in any transaction on or subject to the rules" of a contract market and did not suffer any "actual losses that resulted from such transaction" as required by § 22 of the CEA.

### B. State Law Claims

After dismissing the claims under the CEA for lack of standing, the district court dismissed the supplemental state law claims without prejudice. The NYBOT Defendants, who had argued that the state law claims were preempted by the CEA, cross-appeal on the grounds that the district court should have dismissed Klein's state law claims with prejudice on preemption grounds. We review this dismissal for abuse of discretion. *See Valencia*, 316 F.3d at 304.

It is well settled that where, as here, the federal claims are eliminated in the early stages of litigation, courts should generally decline to exercise pendent jurisdiction over remaining state law claims. *See Kolari v. New York-Presbyterian Hosp.*, 455 F.3d 118, 122 (2d Cir.

2006) ("'in the usual case in which all federal-law claims are eliminated before trial, the balance of factors . . . will point toward declining to exercise jurisdiction over the remaining state-law claims.'") (quoting *Carnegie-Mellon Univ. v. Cohill,* 484 U.S. 343, 350 n.7 (1988)); *Castellano v. Bd. of Trs.,* 937 F.2d 752, 758 (2d Cir. 1991). In deciding whether to exercise jurisdiction over supplemental state-law claims, district courts should balance the values of judicial economy, convenience, fairness, and comity – the "Cohill factors." *See Cohill,* 484 U.S. at 350. The NYBOT Defendants contend that the district court should have retained jurisdiction to decide the important, quintessentially federal question of whether the state law claims are preempted by the CEA. *See Baylis v. Marriott Corp.,* 843 F.2d 658, 665 (2d Cir. 1988) ("One factor that may sometimes favor retaining pendent jurisdiction is when a state claim is closely tied to questions of federal policy and where the federal doctrine of preemption may be implicated.").

Because the decision to retain jurisdiction is discretionary and not a litigant's right, a court is not required either to accept or decline supplemental jurisdiction when a state law claim raises federal preemption issues. *See Kolari,* 455 F.3d at 122; *Valencia,* 316 F.3d at 305 ("In providing that a district court 'may' decline to exercise such jurisdiction, [42 U.S.C. § 1367(c)] is permissive rather than mandatory."); *Baylis,* 843 F.3d at 665 (concluding that the Cohill factors outweighed the federal preemption factor, and that the district court did not abuse its discretion in refusing to exercise supplemental jurisdiction). Following consideration of the

*Cohill* factors, the proper course is left to the court's discretion.[5] *See, e.g., Motorola Credit Corp. v. Uzan,* 388 F.3d 39, 56 (2d Cir. 2004). Our concern, therefore, is solely whether that discretion was abused and we find it was not.

## III. CONCLUSION

For the reasons discussed, the judgment of the district court is affirmed.

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[5] The Cohill factors favor dismissal. When dismissed, this case was in the early stages of litigation. There had been no significant activity aside from the consideration of motions to dismiss. (A 3-7) Comity and fairness also favor dismissal, as it will procure for the parties "a surer-footed reading of applicable law" with regard to the *eight* remaining state law claims. *United Mine Workers v. Gibbs,* 383 U.S. 715, 726 (1966)

## APPENDIX B

2005 WL 427713

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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KLEIN & CO. FUTURES, INC.,

Plaintiff,

- against -

BOARD OF TRADE OF THE CITY OF NEW YORK, NEW YORK CLEARING CORPORATION, NORMAN EISLER and FIRST WEST TRADING, INC., et al.,

Defendants.

MEMORANDUM DECISION & ORDER

00 Civ. 5563 (GBD)

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BOARD OF TRADE OF THE CITY OF NEW YORK and NEW YORK CLEARING CORPORATION,

Plaintiffs,

- against -

KLEIN & CO. FUTURES, INC.,

Defendant.

01 Civ. 4071 (GBD)

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GEORGE B. DANIELS, District Judge:

Plaintiff Klein & Co. Futures, Inc. ("Klein"), a futures commission merchant, alleges various claims under the Commodities Exchange Act and state common law against defendants Board of Trade of the City of New York

("NYBOT"), New York Clearing Corporation ("NYCC"), Norman Eisler, First West Trading, Inc. and other named defendants. Plaintiff seeks to recover damages sustained as a result of the alleged manipulation of settlement prices which caused its default and the seizure of its assets. ("Klein I"). Defendants moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(1), 12(b)(6) and 12(h)(3).

In a separate, but related case, NYBOT and NYCC brought suit against Klein & Co. Futures, Inc. seeking to recover the amounts lost by Klein customers after all of Klein's accounts were seized.[1] ("Klein II"). NYBOT and NYCC, in Klein II, moved for judgment on the pleadings and to dismiss Klein's counterclaims.

Defendants' motions in Klein I are granted and Klein's complaint is dismissed. NYBOT and NYCC's motion for judgment on the pleadings in Klein II is denied. NYBOT and NYCC's motion to dismiss Klein's counterclaims in Klein II is granted.

## BACKGROUND

Plaintiff Klein & Co. was engaged in commodity brokerage services.[2] As a New York futures commission merchant ("FCM") and a clearing member of NYCC, Klein

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[1] NYCC is the clearinghouse subsidiary of NYBOT. NYCC reconciles and clears all futures and options transactions for the exchanges and subsidiaries of NYBOT and assures the financial integrity of such transactions.

[2] Futures Commission Merchants are individuals, associations, partnerships, corporations and trusts that solicit or accept orders for the purchase or sale of futures and options on futures and that accept payment from or extend credit to those whose orders are accepted. FCMs must be registered with the National Futures Association.

facilitated the trades, and guaranteed the obligations of its customers who transacted on the exchange market of NYBOT.[3] On May 15, 2000, First West Trading, Inc. ("First West"),[4] a Klein customer, failed to meet a margin call and defaulted on $4.5 million in options trades transacted on the New York Futures Exchange, Inc. ("NYFE").[5] Through its account with Klein, First West purchased and sold, among other things, contracts in Pacific Stock Exchange Technology Index Futures Contracts and Options ("P-Tech Futures and Options"). First West's inability to meet its margin call became Klein's responsibility as a FCM. Klein's inability to cover the deficit, in turn, led to the eventual collapse of its brokerage business.[6]

Klein contends that its losses stemmed from the actions of Norman Eisler, a former Klein client, a principal of First West Trading, and most importantly, a member of the P-Tech Futures and Options Settlement Committee. The Settlement Committee's primary responsibility was to calculate the settlement price of P-Tech Futures and

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[3] NYBOT maintains contract markets for the trading of futures contracts and options in commodities such as coffee, sugar, cocoa, cotton and financial products by public customers and other entities.

[4] Defendant First West Trading, Inc. is a New York Corporation in the business of trading commodities. Norman Eisler is alleged to have been "a principal of First West." Complaint at 2, ¶ 6.

[5] NYFE is a futures and options exchange designated by the U.S. Commodity Futures Trading Commission ("CFTC") as a contract market for the trading of commodities futures and options, including P-Tech Futures and Options.

[6] A margin call is a notification to a customer from a brokerage firm that the customer needs to raise the equity level in their account to meet the minimum maintenance margin requirements, either by adding additional equity or by selling margined holdings.

Options.[7] Klein alleges that defendant Norman Eisler, in his capacity as a member of the Committee, "incorrectly set the P-Tech Settlement Price for his own benefit and interest, thereby causing the original margin calculation of P-Tech Futures and Options to be incorrect." Complaint at 28, ¶ 172. Since the settlement price is used to calculate margin at the close of the business day, Eisler's miscalculation of the settlement price caused Klein to "incorrectly calculate the price and margin amount cleared through the NYCC for defendant First West's account." *Id.*, ¶ 173.

Plaintiff claims that on May 11, 2000, "the margin call in First West's account was computed to be Seven Hundred Thousand ($700,000) Dollars." *Id.* at 11, ¶ 80.[8] On May 15, 2000, however, First West's account debit ballooned to $4.5 million as a result of the recalculation of P-Tech Futures and Options prices by the Settlement Committee. The recalculated settlement prices were computed without defendant Norman Eisler, who was

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[7] Options prices are based on some underlying commodity, security or index. In the case of P-Tech Futures and Options, their prices are based on a composite index of one hundred technology stocks compiled by the Pacific Stock Exchange. The prices of those stocks and, therefore, the value of that index may change up to the close. When an option is actively traded, the settlement price is usually the price of the last trade. However, when an option is not actively traded, its last price may not represent the price reflected by the index. The Settlement Committee, therefore, is charged with setting the settlement price after the close of the market.

[8] First West notified Klein that it could not meet the margin call. Plaintiff alleges that it contacted NYBOT to discuss First West's inability to meet it's margin call and the illiquidity of the P-Tech Futures and Options. Klein also informed NYBOT that the margin deficit in First West's account, if not covered by Eisler, would exceed Klein's assets.

stripped of his NYBOT membership privileges earlier in the day. "At the opening of business on May 16, 2000, with such a large margin deficit, and no apparent funding available to cover the margin deficit from First West, Klein & Co. was required to take an immediate charge against its net capital for the amount of First West's margin call deficiency." Complaint at 14, ¶ 102. This immediate charge decreased Klein's net capital below the required $2 million minimum for clearing members of NYCC and the New York Mercantile Exchange ("NYMEX"). Klein's membership privileges were suspended, leading to the collapse of its brokerage business.

Plaintiff filed the instant complaint against multiple defendants ("Klein I").[9] Counts I through III of the Complaint assert claims based on various provisions of the Commodities Exchange Act. Count I alleges that NYFE violated § 5b of the Commodities Exchange Act ("CEA") by failing to enforce its own rules, and seeks a declaratory judgment suspending NYFE as a contract market. Count II alleges that the defendants violated the anti-fraud provision in CEA § 4b and 17 C.F.R. §§ 33.9 and 33.10. Count III alleges that defendants violated the insider trading provisions of CEA § 9. The remaining counts

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[9] Defendants NYBOT, the NYBOT Board, NYCC, NYCC Board, Cotton Exchange, NYFE and the Committee are alleged to have a quasi-governmental role in managing, operating and trading the contract markets. They regulate the industry and conduct investigations in order to provide an orderly, fair market. These defendants are alleged to have "violated their duty to enforce the rules and regulations of the CEA and failed in that supervisory duty by allowing" the manipulation of the P-Tech Settlement Price. The various named and unnamed individual defendants were the officers, directors, and/or committee members of those entities.

assert various state law and common law claims including, among others, negligence, conversion and defamation.

Klein's funds were insufficient to cover the account debit Klein inherited from First West. To cover this loss, NYBOT and NYCC confiscated the segregated accounts of *all* of Klein's clients. Soon thereafter, NYMEX, on behalf of Klein's customers, filed suit against NYBOT and NYCC. NYMEX's suit resulted in a settlement between those parties. NYBOT returned the funds from these segregated accounts belonging to Klein customers. Klein customers then assigned their right to the amounts in these accounts to NYBOT. On May 14, 2001, NYBOT and the NYCC brought suit ("Klein II") against Klein seeking to recover over $4 million that Klein customers "validly assigned to NYBOT ... under the Klein Customer Contract." Complaint of NYBOT and NYCC in 01 Civ. 4071 at 6, ¶ 25, ("NYBOT Complaint"). NYBOT and NYCC contend that "Klein's refusal to pay the Customer Claims in full ... constitutes a refusal to credit the Klein Customers (or their assignees) for deficiencies caused by the default of Klein and other customers, and is thus a material breach of the Klein Customer Contract." *Id.*, ¶ 26.

KLEIN I

Defendants Norman Eisler and First West Trading, Inc. moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(1), 12(b)(6), and 12(h)(3). Eisler and First West argue that the Court lacks subject matter jurisdiction because plaintiff lacks standing pursuant to Section 22(a) and 22(b) of the CEA. Specifically, Eisler and First West contend that plaintiff's alleged relationship to defendants does not fall within one of four required relationships under Section

22(a) of the CEA. Additionally, Eisler and First West argue that plaintiff has not met the standing requirements outlined in Section 22(b), because plaintiff did not engage in transactions on, or subject to, the rules of a contract market under the CEA.

The remaining defendants (collectively, the "NYBOT defendants") separately moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) on additional grounds. They argue that plaintiff fails to satisfy the requirements for a private right of action under Section 22(b) of the CEA; that plaintiff lacks standing to assert his claim under § 5b of the CEA; that plaintiff has failed to state a claim of bad faith as required under Section 22; and that plaintiff has failed to plead fraud with particularity as required by Fed. R. Civ. P. 9(b). NYBOT further asserts that this Court has no basis to exercise pendant or supplemental jurisdiction over plaintiff's state law claims once the federal claims are dismissed.

Federal Rule of Civil Procedure 12(b)(6) allows a party to move to dismiss a complaint where the complaint "fail[s] . . . to state a claim upon which relief can be granted[.]" FED. R. CIV. P. 12(b)(6). In reviewing a motion to dismiss, this Court accepts the allegations in the complaint as true and draws all reasonable inferences in favor of the non-moving party. *See Patel v. Searles,* 305 F.3d 130, 134-35 (2d Cir. 2002). Here, a motion to dismiss will only be granted if the plaintiff can prove no set of facts in support of his claim that would entitle him to relief. *See Citibank, N.A. v. K-H Corp.,* 968 F.2d 1489, 1494 (2d Cir. 1992). A court may look at the complaint and any documents attached to, or incorporated by reference in, the complaint. *See Dangler v. New York City Off Track Betting Corp.,* 193 F.3d 130, 138 (2d Cir. 1999).

1. Standing under Section 22 of the Commodities Exchange Act

Section 22 of the CEA requires that a plaintiff stand in at least one of four possible relationships with defendant.[10] Section 22 further provides that private remedies are available only to litigants who "engaged in any transaction on or subject to the rules" of such contract markets or licensed boards of trade. 7 U.S.C. § 25(b)(1)-(3). *See Vitanza v. New York City Board of Trade,* 2002 WL 424699, *5 (S.D.N.Y. March 18, 2002) (finding that "[e]ach of the required relationships involves a situation in which the defendant gave advice related to the sale of commodities or *participated in a transaction related to such sales.*") (emphasis added).

Courts have interpreted this provision to mean that only *purchasers or sellers* on the contract market have a

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[10] Proper parties under Section 22(a) include plaintiffs:

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of –

(i) an option subject to section 6c of this title (other than an option purchased or sold on a registered entity or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

right of action pursuant to Section 22. Non-traders have no such private right of action under the CEA. *See DGM Invs. Inc. v. New York Futures Exchange, Inc.*, 2002 WL 31356362, at *4 (S.D.N.Y. Oct. 17, 2002) (dismissing claim for lack of standing under Section 22 of the CEA by fund operator engaged in commodity transactions where there is no allegation that the operator bought or sold on the exchange); *see also Vitanza,* 2002 WL 424699 at *5 (dismissing claim for lack of standing for failing to adequately plead that plaintiffs have with the defendants one of the four relationships outlined in section 22(a)(1) of the CEA); *see also American Agriculture Movement Inc. v. Chicago Board of Trade,* 977 F.2d 1147 (7th Cir. 1992) (finding that Section 22 of the CEA forecloses remedies on behalf of nontraders).

Plaintiff Klein lacks standing under Section 22 to bring this suit. Klein does not allege that it was either a purchaser or a seller of P-Tech Futures and Options. Furthermore, Klein does not claim that it traded for its own account. Rather, it is undisputed that *First West,* not Klein, traded in P-Tech Futures and Options. Indeed, Klein claims that these trades were effected "without input, counsel, advice or any type of recommendation whatsoever from Klein & Co." Complaint at 8, ¶ 56. Klein further alleges that it "had no equity or financial interest in the First West account nor did Klein & Co. exercise control over the trading in said account." *Id.*, ¶ 57.

Klein contends that as a futures commission merchant and a clearing member, it was subject to federal statutes as well as the rules and by-laws of NYBOT, NYFE and NYCC that required Klein to maintain funds guaranteeing its customers' transactions on the contract market. *See* Complaint at 10, ¶¶ 74-75. Although it is a non-trader,

therefore, Klein argues that it has standing because it was "injured in the course of trading on a contract market." This argument, however, is insufficient to support a finding that Klein had standing under Section 22 of the CEA. In *DGM Investments,* 2002 WL 31356362 *4, another court in this district dismissed the claims of plaintiff DGM for lack of standing. In that case, DGM Investments alleged that as a result of defendant Eisler's manipulation of the settlement price, "DGM's clearing broker advised DGM of a margin call on its accounts . . . , that DGM allegedly met this margin call, as well as another of which it was advised . . . , and that DGM allegedly was unable to meet a third margin call. . . . DGM alleges that as a result of these improper margin calls, it lost its capital and was forced to wind up its affairs." *Id.* at *2. The Court nevertheless found that despite DGM's losses, it neither bought nor sold on the exchange. "By its terms, then, § 22(b) creates the exclusive remedies available to those injured by violations of the CEA, and makes those remedies available only to persons injured in the course of trading on a contract market. It therefore forecloses all other remedies, including any on behalf of non-traders." *Id.*

Klein cannot claim that it bought or sold on the exchange or that it had any interest in P-Tech Futures and Options trading through its customer's accounts. Klein suffered damages because of its customer First West's inability to cover its margin call after the settlement price was recalculated. Quite simply, it did not suffer its damages in the course of its trading activities on a contract market. Klein, therefore, does not have standing to allege a private cause of action under Section 22(b). This finding is consistent with those by other courts in this

district concerning the same defendants, the same issue, and the same alleged scheme as the action presently before this Court. *See Vitanza,* 2002 WL 424699 (dismissing plaintiffs' claims for lack of standing under Section 22 of the CEA). Plaintiff's first three counts, which are all based on violations of the CEA and regulations thereunder, are dismissed.[11]

2. State Law Claims

Defendants urge the Court not to exercise supplemental jurisdiction over plaintiff's state law claims. *See* Eisler and First West Brief at 17, NYBOT Brief at 20. With the dismissal of plaintiff's claims under the CEA and related regulations, all of Klein's remaining claims arise only under state law. 28 U.S.C. § 1367(c) states in pertinent part: "[t]he district courts may decline to exercise supplemental jurisdiction over a claim . . . if – . . . (3) the district court has dismissed all claims over which it has original jurisdiction. . . ." *Id.* Indeed, absent unique circumstances, a federal court should decline to exercise supplement jurisdiction over state law claims when no federal claim survives. As the Second Circuit has explained, "in the usual case in which all federal-law claims are eliminated before trial, the balance of factors to be considered under the pendent jurisdiction doctrine – judicial economy, convenience, fairness, and comity – will point toward declining to exercise jurisdiction over the remaining state-law claims." *Valencia ex rel. Franco v. Lee,*

[11] Defendants also assert that plaintiff fails to state a claim of bad faith and that plaintiff failed to comply with Fed. R. Civ. P. 9(b) in his allegations of fraud. As the Court has dismissed plaintiff's claims for lack of standing, it declines to opine on these other arguments.

316 F.3d 299, 305 (2d Cir. 2003) (quoting *Carnegie-Mellon Univ. v. Cohill,* 484 U.S. 343, 350 n. 7, 108 S.Ct. 614, 98 L.Ed.2d 720 (1988)); *see also Baylis v. Marriott Corp.,* 843 F.2d 658, 664 (2d Cir. 1988) ("The basis for retaining jurisdiction is weak, when as is the case here, the federal claims are dismissed before trial."). This Court declines to exercise supplemental jurisdiction over plaintiff's remaining state law claims. Accordingly, plaintiff's remaining state law claims are dismissed without prejudice.[12]

## KLEIN II

In a separate, but related suit, NYBOT and the NYCC seek to recover from Klein over $4 million that Klein held in segregated accounts for its customers. NYBOT and NYCC allege that Klein's unwillingness to make payment to NYBOT and NYCC constitutes a violation of Section 4d(2) of the CEA, as well as a breach of contract under state law. As is standard practice in the industry, clients of brokerage houses often maintain their assets with their brokerage house or FCM. Section 4d(2) of the CEA, 7 U.S.C. § 6d(2) provides that

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[12] Defendants further assert that should the Court exercise supplemental jurisdiction, Counts IV (Breach of Fiduciary Duty), V (Gross Negligence and Bad Faith), VII (Common Law Fraud), and X (Defamation) which "seek to impose state law upon the operations and official actions of a federally chartered self-regulatory contract markets," are preempted by Section 22 of the CEA and should be dismissed with prejudice. NYBOT Brief at 20-21. As the Court declines to exercise supplemental jurisdiction over all of plaintiff's state law claims, it need not review the merits of defendants' preemption argument.

> Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held.

7 U.S.C. § 6d(2). In its complaint in Klein I, Klein alleges that NYBOT and the NYCC "wrongfully confiscated a sum of money and assets in the amount of approximately Eight Million ($8,000,000.00) Dollars in Customer Funds belonging to customers of Klein & Co. that were held in Klein & Co.'s segregated account at Chase Manhattan Bank. NYBOT and NYCC seized these funds after Klein failed to meet its obligation to pay the amount of First West's margin deficiency.

On May 17, 2000, NYMEX, along with several individual plaintiffs, filed suit seeking to have the funds returned to Klein's former customers. *See New York Mercantile Exchange v. NYBOT,* 00 Civ. 3739 (DLC). On the same day, NYBOT issued a press release stating that their Board of Directors approved a plan designed to "make whole" traders and all other customers who sustained losses as a result of Klein's suspension of membership in the exchanges and the NYCC. On June 30, 2000, NYMEX, Klein's former customers and NYBOT and NYCC reached a settlement whereby NYBOT obtained the right to collect from Klein the amount that Klein allegedly owed its customers whose funds were originally confiscated by NYBOT.[13] NYBOT and NYCC's claims,

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[13] The Agreement and Release signed between NYBOT and NYCC and the individual customers provides that NYBOT and NYCC would

(Continued on following page)

therefore, are based entirely on the premise that Klein still owes its former customers for the amounts that were taken from them, and that such claims are assignable by Klein's former customers to NYBOT and the NYCC.

NYBOT and NYCC allege that Klein's refusal to make payment to them, as assignees of Klein's former customers, constitutes a violation of Section 4d(2) of the CEA, 7 U.S.C. § 6d(2), and 17 C.F.R. §§ 1.20 through 1.22 as well as a breach of contract under common law. Klein, in turn, asserts counterclaims in the Klein II case that are in substance similar to those alleged in his complaint in Klein I. NYBOT and NYCC moved to dismiss Klein's counterclaims. As Klein's claims in the earlier suit were dismissed for lack of standing, his federal counterclaims (Counterclaims One, Two, Three and Four) are likewise dismissed for lack of standing.[14] *See DGM Invs. Inc.*, 2002 WL 31356362 at *4 (dismissing claim for lack of standing under Section 22 of the CEA by fund operator engaged in commodity transactions where there is no allegation that the operator bought or sold on the exchange); *see also*

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return to the customer "the value of the Customer's customer-segregated account with Klein . . . , less loans due Klein or its principals in respect of transactions in the Customer's account with Klein." In exchange for this payment, the customer released NYBOT and NYCC from "any and all claims . . . relating to or arising from the default of Klein and/or First West, including, but not limited to, NYCC's utilization of funds in Klein's omnibus customer-segregated account provided by the Customer." The customer further "assigns to NYBOT . . . all rights, remedies, claims and/or causes of action that the Customer has or may have against Klein and/or First West. . . . " Klein II Complaint, Exhibit B.

[14] Klein's four federal counterclaims in Klein II include: indemnification under the CEA; violations of responsibilities of a contract market under the CEA, violations of § 4b of the CEA and 17 CFR § 33.9 and violation of § 9 of the CEA.

*Vitanza,* 2002 WL 424699 at *5 (dismissing claim for lack of standing for failing to adequately plead that plaintiffs have with the defendants one of the four relationships outlined in section 22(a)(1) of the CEA). Similarly, this Court declines to extend supplemental jurisdiction over Klein's state counterclaims. *see Baylis v. Marriott Corp.,* 843 F.2d 658, 664 (2d Cir. 1988). Klein's counterclaims are therefore dismissed.[15]

NYBOT and NYCC also move for judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c) on the grounds that Klein's answer and affirmative defenses to the NYBOT complaint fail to raise any issue of fact thereby entitling NYBOT and NYCC to judgment as a matter of law. NYBOT and NYCC claim that "Klein's refusal to make payment to NYBOT and NYCC, as assignees of the Klein Customers, of funds segregated or required to be segregated in full or partial satisfaction of Klein's obligations to pay the assigned Customer Claims constitutes a violation of Section 4d(2) of the CEA, 7 U.S.C. § 6d(2), and 17 C.F.R. §§ 1.20 through 1.22." NYBOT Complaint at 5, ¶ 20. Section 4d(2) of the CEA, 7 U.S.C. § 6d(2) provides that

> [s]uch money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held

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[15] Klein asserts state law counterclaims for breach of fiduciary duty, gross negligence and bad faith, conversion, intentional interference with contractual relations and respondeat superior.

7 U.S.C. § 6d(2). "Section 4d(2) provides that FCM's must "treat and deal" with a customer's margin funds and property as the property of such customer, and that such funds shall not be commingled with the FCM's own funds or used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held." *In re Chicago Discount Commodity Brokers, Inc.*, 1987 WL 5256, *3 (N.D.Ill. January 5, 1987).

NYBOT and NYCC, however, make no allegations that Klein commingled their customers funds with its own or that Klein used other customers' funds in order to meet the margin requirement of a separate customer which is the *sine qua non* of alleged violations of Section 4d(2) of the CEA. *See Commodity Futures Trading Commission v. Rosenberg*, 85 F.Supp.2d 424, 451-52 (D.N.J. 2000) (finding that broker and his company violated Section 4d(2) of the Commodities Exchange Act (CEA) when the broker deposited funds, albeit a small amount, into an account, commingling them with investor's monies). Indeed, Klein contends, without challenge, that *NYBOT* and *NYCC* seized *all* assets held by Klein, including the funds in question, in the aftermath of First West's failure to meet its margin call.[16] NYBOT and NYCC's claim that Klein violated Section 4d(2) of the CEA is unsupported by the

[16] The agreement and release entered into by NYBOT, NYCC and Klein's former customers provide that "NYCC utilized funds maintained in Klein's omnibus customer-segregated account at NYCC to satisfy this margin deficiency in accordance with NYCC By-Laws and Rules, including funds that had been provided to Klein by the Customer for the customer-segregated account. . . ." Agreement and Release, NYBOT Complaint, Exhibit B.

allegations in their complaint. Their motion for judgment on the pleadings is therefore denied.

The unchallenged fact that NYBOT and its affiliates seized these accounts also makes their second claim against Klein for breach of contract untenable. In order to establish a prima facie case for breach of contract, a plaintiff must plead and prove: (1) the existence of a contract; (2) a breach of that contract; and (3) damages resulting from the breach. *National Market Share, Inc. v. Sterling Nat. Bank,* 392 F.3d 520, 525 (2d Cir. 2004). NYBOT and NYCC allege that "[t]he Klein Customer Contract constitutes a valid and binding contract between Klein and the Klein Customers" and that "Klein Customers were entitled to return of their account balances under the Klein Customer Contract." NYBOT Complaint at 6, ¶¶ 23-24. They further allege that "Klein Customers validly assigned to NYBOT their rights under the Klein Customer Contract." *Id.,* ¶ 25. If Klein's former customers were entitled to the return of their account balances, however, the undisputed facts of this case bring into question who is ultimately responsible for their return. Indeed, the facts show that NYBOT and its affiliates, who were responsible for taking control of these funds, returned these funds to Klein's former customers in the settlement entered in *New York Mercantile Exchange v. NYBOT,* 00 Civ. 3739 (DLC). Moreover, it is unclear whether any valid claims still exist after the settlement was entered into, or whether all claims by Klein's former customers were extinguished in full accord and satisfaction as a result of the settlement.

Furthermore, NYBOT and NYCC's claim that Klein breached its contract with customers is insufficiently supported by the other allegations in the complaint.

NYBOT and NYCC fail to state what actions Klein took or failed to take which breached the agreement with its customers. As alleged, NYBOT and NYCC contend that Klein had a valid and binding contract entitling its customers to return of their account balances. Assuming that these account balances were not returned, the undisputed facts show that Klein's inability to return these balances was due, in no small part, to the fact that NYBOT seized *all* of Klein's assets, even those that Klein held in segregated accounts. Klein was thereby prevented from returning these balances.

Under these circumstances, NYBOT and NYCC's motion for judgment on the pleadings must be denied. In fact, NYBOT and NYCC's claim fails to allege causes of action entitling them to relief. This Court, *sua sponte,* grants NYBOT and NYCC leave to amend, within sixty (60) days of the date of this decision its complaint in order to set forth sufficient factual allegations to support their conclusory claims of Section 4d(2) violations and breach of contract. NYBOT and NYCC's failure to file an amended complaint within sixty days hereof will result in their action being terminated for failure to state a claim, and the matter under docket number 01 Civ. 4071 being closed.

## CONCLUSION

For the reasons stated above, NYBOT, First West and Eisler's motion to dismiss Klein's complaint in Klein I (00 Civ. 5563) is granted. NYBOT and NYCC motion for judgment on the pleadings in Klein II (00 Civ. 4071) is

denied. NYBOT and NYCC motion to dismiss Klein's counterclaims in Klein II (00 Civ. 4071) is granted.

Dated: New York, New York
February 18, 2005

SO ORDERED:

/s/ George B. Daniels
GEORGE B. DANIELS
United States District Judge

## APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
THURGOOD MARSHALL U.S. COURT HOUSE
40 FOLEY SQUARE,
NEW YORK 10007

**Thomas Asreen**
**ACTING CLERK**

| | |
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| Date: | |
| Docket Number: | 05-1374-cv |
| Short Title: | Klein & Co. Futures v. Board of Trade NYC |
| DC Docket Number: | 00-cv-5563 |
| DC: | SDNY (NEW YORK CITY) |
| DC Judge: | Honorable George Daniels |

(Filed Nov. 14, 2006)

At a stated term of the United States Court of Appeals for the Second Circuit, held at a Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the City of New York, on the day of November two thousand six.

Klein & Co. Futures, Inc.,

Plaintiff-Appellant,

v.

Board of Trade of the City of New York, Inc., New York Clearing Corporation, Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peres, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Hitesh Trivedi, New York Cotton Exchange, Inc., New York Futures Exchange, Inc., Joseph O'Neill, Walter Fair, Evan Thomas and Joseph Jach,

Defendant-Appellee-Cross-Appellant,

First West Trading, Inc. and Norman Eisler,

Defendants-Cross-Appellants,

John Doe 1-10, Richard Roe and Peter Poe,

Defendants.

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant Klein & Co. Futures, Inc. Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT:
THOMAS ASREEN, Acting Clerk
by
/s/ Arthur M. Heller
Arthur M. Heller, Motions Staff Attorney

## APPENDIX D

Section 22 of the Commodity Exchange Act, 7 U.S.C. § 25 (1999), provided at the time this action was filed:

### § 25. Private rights of action

(a) Actual damages; actionable transactions; exclusive remedy

(1) Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person –

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of –

(i) an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) Who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

(2) Except as provided in subsection (b) of this section, the rights of action authorized by this subsection and by sections 7a(11), 18, and 21(b)(10) of this title shall be the exclusive remedies under this chapter available to any person who sustains loss as a result of any alleged violation of this chapter. Nothing in this subsection shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims under this section, including arbitration.

(3) In any action arising from a violation in the execution of an order on the floor of a contract market, the person referred to in paragraph (1) shall be liable for –

(A) actual damages proximately caused by such violation. If an award of actual damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under section 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award; and

(B) where the violation is willful and intentional, punitive or exemplary damages equal to no more than two times the amount of such actual damages.

If an award of punitive or exemplary damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under section 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award if the floor broker fails to do so, except that such requirement shall apply to the futures commission merchant only if it willfully and intentionally selected the floor broker with the intent to assist or facilitate the floor broker's violation.

(b) **Liabilities of organizations and individuals; bad faith requirement; exclusive remedy**

(1) (A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by section 7a(8) and (9) of this title, (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or (C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this chapter or any Commission rule, regulation, or order, shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

(2) A registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title or in enforcing any such bylaw or rule violates

this chapter or any Commission rule, regulation, or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule.

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a contract market, clearing organization, licensed board of trade, or a registered futures association willfully aids, abets, counsels, induces, or procures any failure by any such entity to enforce (or any violation of the chapter in enforcing) any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, shall be liable for actual damages sustained by a person who engaged in any transaction specified in subsection (a) of this section on, or subject to the rules of, such contract market, licensed board of trade or, in the case of an officer, director, governor, committee member, or employee of a registered futures association, any transaction specified in subsection (a) of this section, in either case to the extent of such person's actual losses that resulted from such transaction and were caused by such failure or violation.

(4) A person seeking to enforce liability under this section must establish that the contract market, licensed board of trade, clearing organization, registered futures association, officer, director, governor, committee member, or employee acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss.

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this chapter available

to any person who sustains a loss as a result of (A) the alleged failure by a contract market, licensed board of trade, clearing organization, or registered futures association or by any officer, director, governor, committee member, or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution referred to in this subsection that is alleged to have violated this chapter, or any Commission rule, regulation, or order.

(c) Jurisdiction; statute of limitations; venue; process

The United States district courts shall have exclusive jurisdiction of actions brought under this section. Any such action shall be brought not later than two years after the date the cause of action arises. Any action brought under subsection (a) of this section may be brought in any judicial district wherein the defendant is found, resides, or transacts business, or in the judicial district wherein any act or transaction constituting the violation occurs. Process in such action may be served in any judicial district of which the defendant is an inhabitant or wherever the defendant may be found.

(d) Dates of application to actions

The provisions of this section shall become effective with respect to causes of action accruing on or after the date of enactment of the Futures Trading Act of 1982 [January 11, 1983]: Provided, That the enactment of the Futures Trading Act of 1982 shall not affect any right of any parties which may exist with respect to causes of action accruing prior to such date.

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(3)

Supreme Court, U.S.
FILED
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No. 06-1265

IN THE

# Supreme Court of the United States

KLEIN & CO. FUTURES, INC.,
*Petitioner,*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., *et al.*,
*Respondents.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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April 18, 2007

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## COUNTERSTATEMENT OF QUESTION PRESENTED

Whether the court of appeals correctly held that a futures commission merchant ("FCM") that handled and cleared trades for its customer lacked standing to assert claims against a contract market and a clearing organization under former Section 22(b) of the Commodity Exchange Act (7 U.S.C. § 25(b) (1999)) to recover losses resulting from its customer's failure to pay margin calls, on the ground that the FCM's claims did not arise from its own trading losses as a result of any transaction on or subject to the rules of the contract market.

## RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, respondent Board of Trade of the City of New York, Inc., a New York Not-for-Profit Corporation ("NYBOT"), states that, following a January 12, 2007 merger, NYBOT's successor in interest is Board of Trade of the City of New York, Inc., a Delaware corporation, a wholly owned subsidiary of IntercontinentalExchange, Inc. ("ICE"), a Delaware corporation publicly traded on the New York Stock Exchange. Respondents New York Clearing Corporation ("NYCC"), a clearinghouse, and New York Futures Exchange, Inc. ("NYFE"), a contract market, state that they are wholly owned subsidiaries of NYBOT. Respondent New York Cotton Exchange ("NYCE") no longer exists.

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IN THE

# Supreme Court of the United States

No. 06-1265

KLEIN & CO. FUTURES, INC.,
*Petitioner*,

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., *et al.*,
*Respondents.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

## OPINIONS BELOW

Respondents NYBOT, NYCE, NYFE and NYCC (collectively, the "NYBOT Respondents") submit this opposition to the petition of Klein & Co. Futures, Inc. ("Klein" or "Petitioner") for a writ of certiorari to review the opinion and judgment of the United States Court of Appeals for the Second Circuit, filed September 18, 2006, in *Klein & Co. Futures, Inc. v. Board of Trade of New York*, 464 F.3d 255 (2d Cir. 2006). The opinion of the court of appeals is set forth in the Appendix to the Petition at 1a-15a. The opinion of the district court is set forth in the Appendix to the Petition at 16a-34a.

## STATUTORY PROVISION INVOLVED

Section 22 of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 25 (1999), entitled "Private rights of action," as it existed in July 2000 when Petitioner commenced the underlying action, is set forth in the Appendix to the Petition at 37a-41a. Section 22 was amended in December 2000, and the subsection of the statute at issue here has been amended. *See* Point C, *infra*.

## COUNTERSTATEMENT OF THE CASE

The Petition seeks review of the decision by the court of appeals affirming the district court's dismissal with prejudice of Klein's federal claims under the CEA against NYBOT, NYFE, NYCE and NYCC.

In the district court, Petitioner Klein, an FCM and a clearing member of NYCC, alleged that its customer, defendant Norman Eisler ("Eisler"), a member of the NYFE Settlement Committee, manipulated the settlement prices of P-Tech futures and options traded on NYFE, a contract market, and that in May 2000, when the settlement prices were recalculated, Klein incurred losses because its customer, Eisler, and his company, First West Trading, Inc. ("First West"), could not pay margin calls issued by Klein resulting from First West's trading losses. First West's default on its obligations to Klein triggered a series of events that, because of Petitioner's limited capital, led to Petitioner's collapse.

On July 20, 2000, Petitioner filed its complaint in the United States District Court for the Southern District of New York (Daniels, J.) against Eisler, First West and the NYBOT Respondents. In its complaint, Petitioner claimed that it was wrongfully injured as a result of Eisler's conduct and First West's margin default, and Klein's resulting collapse. *See* Pet. App. at 17a. Klein alleged that it "'had no equity or financial interest in the First West account nor did Klein &

Co. exercise control over the trading in said account.'" *Id.* at 24a.

Petitioner asserted claims for violations of the federal commodities laws and various state law claims. Count I of the Complaint alleged that the contract market NYFE violated CEA § 5b by failing to enforce its rules. Count II alleged that defendants violated the anti-fraud provisions in CEA § 4b and 17 C.F.R. §§ 33.9 and 33.10 thereunder. Count III alleged that defendants violated the insider trading provisions of CEA § 9. Counts IV-XI of the Complaint alleged a variety of state law claims against the defendants.[1]

The NYBOT Respondents moved before the district court to dismiss Petitioner's CEA claims on the grounds, among other things, that Petitioner was not a trader and thus lacked standing under CEA § 22(b).[2] Eisler and First West also moved to dismiss for lack of standing under Section 22(a). The NYBOT Respondents argued that Petitioner did not base its claims on any trading of futures contracts or options done for its own account and, therefore, lacked standing under CEA § 22.

On February 18, 2005, the district court dismissed Petitioner's federal claims with prejudice for lack of standing under CEA § 22. As to the NYBOT Respondents, the district

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[1] In a countersuit against Klein pending in the district court, NYBOT and the clearinghouse NYCC sought to recover from Klein over $4 million lost by the innocent customers of Klein whose assets were seized as a consequence of Klein's default, which customer losses NYBOT voluntarily paid to Klein's customers and seeks to recover from Klein. *See* Pet. App. at 17a.

[2] The NYBOT Respondents also moved to dismiss Petitioner's CEA claims on the ground that Petitioner did not allege conduct that amounts to bad faith on the part of the NYBOT Respondents as required by CEA § 22(b). The NYBOT Respondents also moved to dismiss Petitioner's state law claims on the ground that these claims were preempted by the CEA.

court held: "Quite simply, [Klein] did not suffer its damages in the course of its trading activities on a contract market. Klein, therefore, does not have standing to allege a private cause of action under Section 22(b)." Pet. App. at 25a.

On September 19, 2006, a panel of the United States Court of Appeals for the Second Circuit affirmed the district court's decision and held: "[E]nforcing the statute that Congress wrote, we conclude Klein lacks standing because it was not 'engaged in any transaction on or subject to the rules' of a contract market." Pet. App. at 13a. On November 14, 2006, the court of appeals denied Petitioner's request for rehearing and rehearing *en banc*. Pet. App. at 35a-36a. On March 14, 2007, Petitioner filed its Petition for a writ of certiorari.

## ARGUMENT

"A petition for writ of certiorari will be granted only for compelling reasons" such as where "a United States court of appeals has entered a decision in conflict with the decision of another United States court of appeals on the same important matter . . . [or] a United States court of appeals has decided an important question of federal law that has not been, but should be, settled by this Court." S. Ct. R. 10(a), (c).

Petitioner argues in error that the court of appeals' decision created a conflict with the decisions of other United States courts of appeals. Petitioner further argues in error that, if left undisturbed, the court of appeals' decision will have an adverse impact on the nation's economy by increasing futures trading transaction costs. As set forth below, neither of these arguments can withstand scrutiny. There is no reason for this Court to grant the writ.

CEA § 22 did not, as Petitioner claims, manifest a Congressional intent to expand private rights of action under the CEA. *See* Pet. at 7-8. Congress enacted CEA § 22 to limit private rights of action following this Court's decision in

*Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 388 (1982), which recognized but did not define an implied private right of action under the CEA. In enacting Section 22, Congress sought to define and circumscribe the private rights of action under the CEA that could be brought against, *inter alia*, contract markets, licensed boards of trade and clearing organizations. 7 U.S.C. § 25.

Section 22(b)(1), as it existed when Petitioner commenced the underlying action, explicitly limited standing to those who "engaged in any transaction on or subject to the rules of [a] contract market or licensed board of trade" *and* sustained "actual losses that resulted from such transaction . . . ." 7 U.S.C. § 25(b)(1) (1999). These provisions, taken together, make it clear that the word "transactions," as used in Section 22(b), refers to exchange trades, and that the phrase "actual losses" refers to exchange trading losses. *American Agric. Movement, Inc. v. Board of Trade of Chi.*, 977 F.2d 1147, 1153 (7th Cir. 1992) (Section 22(b) "forecloses all other remedies, including any on behalf of non-traders"); *see FTC v. Ken Roberts Co.*, 276 F.3d 583, 589 (D.C. Cir. 2001) ("transactions" under the CEA means trades on a contract market), *cert. denied*, 537 U.S. 820 (2002). Thus, to have standing, Petitioner had to have traded futures or options on a contract market and suffered trading losses as a result. Petitioner did neither.

All of the economic gains or losses of the trading belonged to First West, not Petitioner. There is no dispute that Petitioner did not incur trading losses and is not seeking to recover for trading losses. Petitioner's own complaint pled that Petitioner did not own or trade the P-Tech options at issue. *See* Pet. App. at 24a. Instead, as the court of appeals held (*see id.* at 12a), Petitioner sought to recover credit losses that resulted from the failure of First West, its customer, to

pay margin calls issued by Petitioner as the result of First West's trading losses.[3]

Customer credit losses sustained by a broker are simply not losses arising from exchange transactions as described by CEA § 22. The losses Petitioner seeks to recover were caused by First West's failure to pay Petitioner the margin debts that it owed to Petitioner under its customer agreement.

Based on these fundamental facts of record, the court of appeals correctly held that Petitioner lacked standing to bring CEA claims against the NYBOT Respondents under Section 22(b) because Petitioner was not itself a trader, but merely "a broker or agent that earned commissions for handling its customer[s'] trades." Pet. App. at 9a. The court of appeals' holding thus affirmed the findings of the district court that "Klein does not claim that it traded for its own account." *Id.* at 24a. "Rather," the district court continued, "it is undisputed that *First West*, not Klein, traded . . . [and] Klein suffered damages because of its customer First West's inability to cover its margin call." *Id.* at 24a-25a.

Although the court of appeals held that the Petitioner had no standing based on the fact that Klein acted as an agent for its customers, Petitioner fails to address this issue altogether. In fact, the word "agent" does not even appear in the Petition. Petitioner's failure to acknowledge that the outcome below was controlled by the undisputed fact that Petitioner, as FCM, acted only as an agent for its customer undermines each of its arguments and indicates that the Petition should be denied.

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[3] As the court of appeals stated, "whether the First West trading positions rose or declined in value, Klein had no interest in any of the resulting profits or investment losses." Pet. App. at 12a. FCMs, when acting as agents, may lose money when their customers fail to reimburse them for margin posted in respect of the customer's positions; FCMs may well fail to be reimbursed for margin, but an FCM does not itself suffer its customer's trading losses.

## I. THE COURT OF APPEALS' DECISION DID NOT CAUSE A SPLIT AMONG THE CIRCUITS

Petitioner argues that the court of appeals' decision created some unspecified split among the circuits. *See* Pet. at 3, 15, 23-26. Petitioner asserts that "[t]he ruling below conflicts with decisions of other circuits . . . that correctly interpret the role of futures commission merchants as critical principals who engage in transactions on, and subject to the rules of, boards of trade." *Id.* at 23. Petitioner is in error for the simple reason that the courts below found that Klein in the transactions at issue acted merely as agent or broker. The court of appeals' decision denying standing to Petitioner under Section 22(b) is entirely consistent with the decisions of the other circuits that have interpreted Section 22(b).

### A. The Petition Fails To Identify Any Decision By Any Court That An FCM As Non-Trader Has Standing To Pursue Claims Under Section 22(b)

The Petition fails to identify any decision, and we are aware of no decision, by any court holding that an FCM, like Petitioner, when handling trades for a customer, has standing under CEA § 22(b). Instead, Petitioner claims that the decision below created some attenuated "conflict," because the court of appeals lacked appreciation for the role of an FCM. The court of appeals, however, understood exactly what an FCM does and does not do. The court of appeals explained:

> As a[n] FCM, Klein facilitated the trading and fulfilled certain obligations of its customers who traded through the NYBOT. . . . Klein functioned merely as a broker or agent that earned commissions for handling its customer[s'] trades. As a clearing member, Klein cleared their trades and was obligated to post margins for them as required.

Pet. App. at 3a, 9a-10a.

This analysis and conclusion was plainly correct. Under Section 22(b), the issue before the court of appeals was whether the FCM engaged in the trades itself, *i.e.*, whether its exchange transactions caused the damages it seeks. Petitioner was not the trader, no trades caused its own losses, and therefore, Petitioner lacked standing.

### B. The Court Of Appeals' Decision Is Consistent With The Decisions Of The Seventh Circuit And Other Courts

The court of appeals' holding that Petitioner was a non-trader that lacked standing is consistent with every court decision that has considered the scope of the private right of action under Section 22(b). *See, e.g.*, *American Agric.*, 977 F.2d at 1153 (the CEA "forecloses all other remedies, including any on behalf of non-traders"); *DGM Invs., Inc. v. New York Fut. Exch., Inc.*, No. 01 CIV. 11602, 2002 WL 31356362, at **3-5 (S.D.N.Y. Oct. 17, 2002); *Vitanza v. Board of Trade of N.Y., Inc.*, No. 00 CV 7393, 2002 WL 424699, at **4-6 (S.D.N.Y. Mar. 18, 2002); *Unity House, Inc. v. First Comm'l Fin. Grp.*, No. 96C-1716, 1997 WL 701345, at *7 (N.D. Ill. Nov. 5, 1997) (adopting reasoning of *American Agriculture* in context of § 22(a) claim), *aff'd*, 175 F.3d 1022 (7th Cir. 1999); *de Atucha v. Commodity Exch., Inc.*, 608 F. Supp. 510, 522 (S.D.N.Y. 1985) (Section 22(b) "plainly limits the private remedy to market traders").

Passing by these decisions, Petitioner contends that the court of appeals' decision conflicts with other decisions of the Seventh Circuit. Pet. at 24. No such conflict exists. The Seventh Circuit, which interpreted Section 22(b) in *American Agriculture* consistently with the Second Circuit, held that the term "transactions," as used in Section 22(b), refers to exchange trades, and therefore that Section 22(b) creates a cause of action only for traders on a contract market who were

injured in the course of trading. 977 F.2d at 1153. Specifically, in *American Agriculture*, the Seventh Circuit held:

> By its terms, then, § 22(b) creates the exclusive remedies available to those injured by violations of the CEA, and makes those remedies available *only to persons injured in the course of trading on a contract market.* It therefore forecloses all other remedies, *including any on behalf of non-traders.* To the extent (if any) that pre-1974 courts had implied private remedies against exchanges in favor of non-traders, Congress directed them to stop doing so in § 22(b).

*Id.* (emphasis added). The Seventh Circuit's decision in *American Agriculture* is entirely consistent with the court of appeals' decision below, which precludes non-traders like Petitioner from pursuing claims under Section 22(b).

Asking this Court to ignore the ruling in *American Agriculture* and limit its holding to its facts,[4] Petitioner seeks to rely on an outdated Seventh Circuit decision not even decided under Section 22 of the CEA, *Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179 (7th Cir. 1984). In *Bernstein*, the Seventh Circuit, in describing the clearing (not the execution) of trades, stated that the clearing "contract of sale is actually between the floor trader's clearing member . . . and the buyer's clearing member," and referred to *Leist v. Simplot*, 638 F.2d 283, 286-87 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), for an accurate and "more detailed description of commodities trading." 738 F.2d at 181. Judge Friendly,

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[4] Petitioner argues that the holding of *American Agriculture* should be limited to its facts because the farmers there, who sold the agricultural commodities underlying the futures contracts being bought and sold, were not as involved in the market as are FCMs like Petitioner. However, like the farmers in *American Agriculture*, Petitioner did not "engage[] in any transaction on or subject to the rules of such contract market" that resulted in "actual losses . . . from the transaction." 7 U.S.C. § 25(b)(1).

writing for the panel in *Leist*, observed (more accurately) that clearinghouses "treat" FCMs "as if" they were principals, recognizing thereby that FCMs are *not* the actual principals on exchange trades, because it is their customers, the traders, that are the principals.[5] 638 F.2d at 286-87.

Nothing in *Bernstein* had anything to do with standing under the CEA. CEA § 22(b) was not yet in effect when Bernstein commenced his action. 738 F.2d at 185. Petitioner's reliance on *Bernstein* to support its circuit split argument is without merit.

Also without merit is Petitioner's reliance on language in other court decisions that make passing reference to FCMs and their role. Although these decisions state that FCMs participate in futures transactions (which they do by providing ancillary services), the very language relied upon by Petitioner is consistent with the court of appeals' holding that FCMs, when acting for customers, are not traders, but instead are merely brokers who act as agents on behalf of their customers, the parties who actually engage in the exchange transactions.[6] *See* Pet. at 23-26; *Bibbo v. Dean Witter Reynolds, Inc.*, 151 F.3d 559, 560 (6th Cir. 1998) ("[f]utures trades are executed *on a customer's behalf* by an FCM") (emphasis added); *In re Western Fin. Mgmt.*, CFTC No. 81-18, 1983 WL 29657, at *11 (C.F.T.C. Oct. 14, 1983) (noting

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[5] A clearing member therefore might be better characterized as an agent for undisclosed principals. The contract and the rights thereunder belong to the principal, not the agent. Claims by an agent based on conduct taken on behalf of another (*i.e.*, handling orders and clearing trades), do not provide the agent with the contract rights of its principal, and thus are outside the scope of the private right of action afforded under Section 22(a).

[6] Of course, when an FCM is trading for its own account it may be entitled to standing under Section 22. Here, however, Petitioner acted solely as an agent for its customer, and was not a trader. Therefore, Petitioner lacks standing.

that an FCM "trades futures *for the investing public*" and makes futures contracts "*on behalf of* any other person") (emphasis added); *Nagel v. ADM Investor Servs., Inc.*, 217 F.3d 436, 439 (7th Cir. 2000) (observing that "futures contracts [must] be sold *through* commodity exchanges and the futures commission merchants registered on those exchanges") (emphasis added); *Bosco v. Serhant*, 836 F.2d 271, 273 (7th Cir.) ("[t]o do the actual trading of the futures [one needs] *the services* of both a clearing member of the Exchange . . . and a futures commission merchant, *who acts as custodian* of the investors' funds") (emphasis added), *cert. denied sub nom.*, 486 U.S. 1056 (1988); *Scott v. Prudential Sec., Inc.*, 141 F.3d 1007, 1013 (11th Cir. 1998), *cert. denied*, 525 U.S. 1068 (1999). As the court of appeals observed here, an FCM like Klein was but an agent; "Klein was not a trader of P-Tech contracts; nor did it own the P-Tech contracts at issue." Pet. App. at 9a.

The conclusion that an FCM like Petitioner has no standing because it acted only as a broker or agent is entirely consistent with the statutory definition of an FCM. CEA § 1a(20) defines an FCM as any person who (A) "is engaged in soliciting or accepting orders . . ." and (B) "in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades." 7 U.S.C. § 1a(20). In other words, FCMs solicit or accept "orders" on behalf of customers (*i.e.*, the FCM acts as an agent), and accept money, securities or property to guarantee the "trades or contracts" that result from those orders. In sum, the decisions below are entirely consistent with prior decisions under the CEA and with the statute itself.

### C. Petitioner Cannot Base Standing On Section 4(a)(1)

In its effort to find an issue where one does not exist, Petitioner claims that the court of appeals' decision is incompatible with CEA § 4(a)(1), which generally prohibits off-exchange trading of futures and options.[7] Specifically, Petitioner claims that, as a result of Section 4(a)(1), virtually everything an FCM does for a customer "in connection with" that customer's trading activity must be done on or subject to the rules of a contract market. Otherwise, Petitioner reasons, Section 4(a)(1) would render the FCM's conduct "off exchange" and thus unlawful. Petitioner's arguments are erroneous. The customer agreement between an FCM and its customers is not an activity on or subject to the rules of a contract market. Nothing about the court of appeals' decision is inconsistent with Section 4(a)(1).[8]

An FCM like Klein that also acts as a clearing member may facilitate futures or options trading in different capacities: (1) as a principal who trades for its own account, or (2) as a broker or agent that handles customer orders and/or clears customer trades through the exchange clearinghouse (here NYCC). Both of the latter functions are as broker or agent. It is undisputed that Petitioner's claims here did not

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[7] Section 4(a) is codified at 7 U.S.C. § 6(a). The Petition erroneously refers to 7 U.S.C. § 6(a) as "Section 6(a)". *See* Pet. at 21.

[8] The text of Section 4(a) confirms that the court of appeals reached the correct result. Section 4(a) is entitled "Restriction on futures *trading*" (emphasis added) and, in the context of discussing lawful futures contracts (*i.e.*, futures trading), it uses virtually the same language as Section 22(b) (*i.e.*, "transaction is conducted on or subject to the rules of a [contract market]"). *Compare* 7 U.S.C. § 6(a)(1) *with* 7 U.S.C. § 25(b)(1). We respectfully submit that this is not a coincidence.

arise out of its own trades. Thus, they must have arisen out of its role as broker and agent for its customer First West.[9]

Like the court of appeals' decision below, the text of Section 4(a)(1) itself recognizes the distinction between the conduct of trading principals and the conduct of FCMs as agents. In particular, Section 4(a)(1) makes it unlawful for an FCM, like Klein, to confirm the execution of a customer's futures contract if that *customer's trade* is not entered into on or subject to the rules of the contract market. 7 U.S.C. § 6(a)(1). Such conduct (and virtually any other conduct undertaken by an FCM for a customer in connection with a futures transaction), places the FCM in the position of an agent.

As such, when an FCM engages in conduct on behalf of its customer (*e.g.*, entering orders, handling orders, and clearing trades) that conduct does not constitute the FCM's own "transaction" that gives rise to claims for "actual losses that resulted from such transaction" as required by Section 22(b). Here Petitioner's losses arose from its customer's failure to pay for trading losses by posting margin required of the customer under Petitioner's customer agreement. That customer agreement is not an exchange transaction; it is a private contract exterior to the trading on the exchange. While Section 4(a)(1) prohibits off-exchange trading, it does not address or regulate the private contractual arrangement between the Petitioner and First West that caused Petitioner's losses here.

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[9] The Futures Industry Association ("FIA"), which intends to file an amicus brief with this Court in support of the Petition, filed an amicus brief in another CEA-related action that explicitly described its members as "FCMs [who] buy and sell futures . . . *as agents* on behalf of their customers." FIA Amicus Brief at 3, *in CFTC v. Eustace*, No. 05 CV 2973 (E.D. Pa. Jan. 18, 2006) (emphasis added), available at http://www.futuresindustry.org/downloads/FIAAmicusBrief_0106.pdf.

### D. Petitioner's Clearing Activities Did Not Constitute Transactions On Or Subject To The Rules Of A Contract Market

In a further effort to find an exchange "transaction" that would give rise to standing, Petitioner points to its involvement in the trading process as a clearing broker. *See* Pet. at 24-25. As a clearing broker, Petitioner dealt with the clearinghouse NYCC and cleared customer trades, subject to NYCC's rules. *See* Pet. App. at 11a, 24a. However, this argument fails because NYCC is a clearing organization, not a board of trade or contract market.

Under Section 22(b) as it existed when this case began, transactions subject to the rules of a clearinghouse did not give rise to standing. In particular, the language of the CEA, as it then existed, demonstrates that, when Congress drafted Section 22, it deliberately distinguished between "contract markets" and "licensed boards of trade" on the one hand, and on the other hand, "clearing organizations" with which FCMs interact in their capacity as clearing members. Section 22(b)(1)(A) itself reflects this conscious decision by the 1982 Congress to distinguish between these entities.[10] *See* Pet. at 2.

In the first sentence of Section 22(b)(1)(A), Congress listed contract markets, clearing organizations, and licensed boards of trade as three distinct entities. *See* 7 U.S.C. § 25(b)(1)(A) (1999). However, later in the same subparagraph, Congress explicitly stated that plaintiffs only have standing if they "engaged in any transaction on or subject to the rules of such contract market or licensed board of trade." *Id.* By omitting "clearing organizations" from this latter clause, Congress

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[10] Other provisions contained in the pre-2000 version of the CEA make it clear that Congress distinguished clearing organizations from exchanges. *See, e.g.*, 7 U.S.C. §§ 2a(vi)(II), 6d, 10a (1999) (referring separately to contract markets and clearing organizations).

intentionally excluded FCM clearing activities from the term "transactions" as that term is used in the statute. This makes sense because "transactions on a contract market" refers to trades, not to clearing.

Congress' careful identification of parties in Section 22(b)(1)(A) further confirms that the same word "transactions," as used in Section 22(a)(1), also refers to trades (and not clearing activities), as trades are conducted on an exchange, and trades are not transactions on or subject to the rules of a clearing organization. Thus an examination of the statute itself demonstrates that Petitioner's clearing of its customer trades through the clearinghouse subject to NYCC's rules did not afford it standing under the CEA.

The Petitioner apparently contends that its customer agreement with First West was somehow a "transaction" subject to the rules of the clearinghouse, NYCC, which Klein incorrectly seeks to characterize as a "contract market." *See* Pet. at 6, 7, 27. The argument is without merit. NYCC is a clearing organization, not a contract market. As was made perfectly clear in CEA § 5 as in effect at the relevant time, a "contract market" is a "board of trade" designated as a contract market by the CFTC. Similarly, Section 22(b)(1)(A) clearly distinguishes between a "contract market" and a "clearing organization."[11] 7 U.S.C. § 25(b)(1)(A). The only "contract market" at issue in this case was NYFE, which was where First West and Eisler did their trades. Klein then cleared its customers' trades through the clearinghouse NYCC, which was not then, and is not today, a contract market or a board of trade.

[11] This distinction was preserved in the 2000 amendments to the CEA by explicitly creating a brand new regulatory regime specifically applicable only to clearing organizations in what is now Section 5b of the Act. *See* 7 U.S.C. § 7a-1 (2000).

Accordingly, any losses suffered by an FCM as a result of its role as a clearing broker for a customer, including the credit losses suffered by Petitioner, are not losses that "result from [a] transaction" that is subject to a rule of any contract market as defined by Section 22(b). Indeed, even if a "transaction" with a clearinghouse alone could support standing, here the Petitioner dealt with the clearinghouse as agent for its customer. Petitioner's losses were credit losses suffered as a result of its customer's failure to reimburse it for margin payments due to the Petitioner under its customer agreement.

### E. The Legislative History Refutes Petitioner's Assertion That Congress Intended To Confer Standing On Market Participants Who Did Not Trade

The court of appeals held that Petitioner as a non-trader FCM lacked standing under Section 22(b) to pursue claims against the NYBOT Respondents. The court of appeals reached this result based on the plain language of the statute, without resort to legislative history. *See* Pet. App. at 11a. However, notwithstanding Petitioner's arguments, the court of appeals' holding is entirely consistent with the legislative history of Section 22.

Citing a House "Conference" Report, Petitioner contends that it should have standing as a "market participant," and that Congress intended to deny the private right of action only to "'members of the public who did not partic[ipate] in the market and claimed to be injured in commercial transactions by declines in commodity prices.'"[12] Pet. at 28-29 (*quoting*

[12] It appears the Petition mis-cited the relevant page of the House Report (incorrectly identified as a "Conference" report), as the phrase "market participants" does not appear on page 57 of the House Report. The quote actually appears at page 145, which sets forth the Committee on Agriculture's report that summarizes amendments that became Section

H.R. Rep. No. 97-565(I), at 57 (May 17, 1982)) (emphasis omitted). Petitioner argues that because it engaged in clearing activities or otherwise acted as an agent for First West, it was a "market participant."

The legislative history of the 1982 amendments, however, makes clear that "market participants" refers to "commodity investors" and "investors in futures markets" (*i.e.*, customers or traders), and thus that traders are the only parties who may bring a private cause of action against a board of trade, contract market or clearing organization. Specifically, when the principal proponent of the legislation, Rep. Dan Glickman, proposed amendments to the CEA that became Section 22, the Congressman said he did so to "[a]llow *commodity investors* who suffer actual damages the right to sue both brokers and exchanges for violations of the Commodity Exchange Act." H.R. Rep. No. 97-565(I), at 239 (emphasis added). He went on to add: "Without [these amendments], I feel that *investors in futures markets* will face potentially greater and greater uncertainty and risk." *Id.* at 240 (emphasis added).

This legislative history thus accords with the court of appeals' holding, and confirms that Congress intended to limit the universe of potential plaintiffs to customers or traders who sustained losses as the result of their transactions on a contract market.[13] As the court of appeals stated, "Klein's loss was a credit loss, not a trading loss." Pet. App. at 12a.

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22, which were proposed by Rep. Dan Glickman and ultimately enacted by Congress.

[13] Likewise, the legislative history states: "[t]he cause of action in these cases would be restricted to cases where the plaintiff has engaged in a regulated *commodity transaction* and could show that there was bad faith in failing to take the necessary action." H.R. Rep. No. 97-565(I), at 57 (emphasis added).

## II. THE COURT OF APPEALS' INTERPRETATION OF SECTIONS 22(a) AND 22(b)(1) IS CONSISTENT WITH PRINCIPLES OF STATUTORY CONSTRUCTION

Petitioner argues that the court of appeals "plainly misread" Section 22(b) when it purportedly grafted the Section 22(a)(1)(A)-(D) enumerated categories standing requirements onto suits brought under Section 22(b)(1). *See* Pet. at 26. Specifically, Petitioner contends that unlike Section 22(b)(2) and (b)(3), Section 22(b)(1) omits the phrase "engaged in any transaction specified in subsection (a) of this section," and instead defines a proper plaintiff merely as "a person who engaged in 'any' transaction on or subject to the rules of such contract market or licensed board of trade." *Id.* at 27.

The statute and the parties who were defendants-appellants in the court of appeals make that court's holding readily understandable. Petitioner Klein named various categories of defendants in its complaint: its customer First West, several individuals (Eisler and other exchange officials), contract markets (NYFE, NYCE), the clearing organization (NYCC), and the exchange holding company (NYBOT). Notably, the Petition fails to address the fact that the court of appeals' ruling applied to all of these different individual and corporate defendants, including Eisler, First West, and the NYBOT Respondents and the individuals who worked for them.[14]

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[14] Klein twice makes the erroneous assertion that it did not appeal to the court of appeals from the district court's decision dismissing the action against Eisler and First West. *See* Pet. at ii, 12 n.5. We assume counsel's error is the result of confusion, not craft. In particular, we trust that counsel on the Petition is not attempting to advance its Section 22(a)(1)(A)-(D) enumerated categories argument by misleading this Court as to whether the appeal below included Eisler and First West (who Klein concedes may only be sued by a plaintiff that falls within the enumerated categories) and thus attempting to obscure the fact that the reference by the court of

It is undisputed that the enumerated categories in Section 22(a)(1)(A)-(D) applied to Klein's claims against Eisler and First West; indeed, Klein does not seek review of that decision. The text of the court of appeals' holding did not distinguish with any precision between Eisler, First West, the individual defendants, the exchange and the NYCC. *See, e.g.*, Pet. App. at 8a-12a. Instead, the opinion broadly stated that "[t]he text of [Sections 22(a) and (b)] requires that a putative plaintiff fall within one of the four required relationships set forth in [Section 22(a)(1)(A)-(D)]." *Id.* at 7a-8a. Placed in context, it is apparent that the court of appeals was addressing the defendants as a whole.

Contrary to Petitioner's statutory construction analysis, by omitting an explicit reference to the subsection (a)(1)(A)-(D) categories in subsection (b)(1), Congress did *not* signal an intention to broaden the class of potential plaintiffs who can bring claims against exchanges to include non-trading FCMs. Instead, Congress, by its omission of a cross-reference, deliberately *narrowed* the class of plaintiffs who can bring claims against contract markets, clearing organizations and licensed boards of trade, and in pursuit of this goal, protected these entities from suits by non-traders.

The legislative history of Section 22 and the court of appeals' decision (even as described by Petitioner) is consistent with this reading of Section 22(b) and the conclusion that Congress intended to require prospective plaintiffs to clear *both* the hurdles established by Section 22(a)(1)(A)-(D) *and* the requirement of an exchange transaction when pursuing a claim against a board of trade, contract market or clearing organization under Section 22(b). *See* H.R. Rep. No. 97-565(I), at 145. Specifically, the legislative history explains that the Glickman Amendment, which Congress ultimately

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appeals to those categories included reference to Eisler and the other individual defendants.

adopted and enacted as Section 22, "authorized an action for damages by a person *who engaged in the transactions listed above* [referring back to the Section 22(a)(1)(A-D) categories] against . . . a contract market (or clearing organization) that failed to enforce rules that served as a basis for its designation." *Id.* (emphasis added). Thus the construction advanced by the court of appeals is not inconsistent with the statute; rather, it is consistent with both the statutory text and the legislative history.[15]

Finally, even if this Court were to disagree with this aspect of the court of appeals' statutory construction, the result reached below is still correct. As set forth above and as numerous courts have held, Section 22(b) creates a cause of action only for traders on a contract market who are injured in the course of trading. *See American Agric.*, 977 F.2d at 1153. As a matter of law, non-traders like Petitioner lack standing to pursue claims under Section 22(b). *See* Point I.A.2, *supra*.

## III. GRANTING THE PETITION WOULD BE IMPROVIDENT AS THE STATUTORY PROVISION THAT IS THE SUBJECT OF THE PETITION HAS BEEN AMENDED

In an effort to turn a decision dismissing a complaint by one failed business into an event that altered the legal landscape, Petitioner argues that the court of appeals' decision, if left unreviewed, would have an adverse effect on futures markets because the decision shifts market risk away

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[15] For example, a Section 22(a)(1)(A) plaintiff could be a person who held a futures position but did not engage in further trading based on trading advice from the defendant for a fee. Such a plaintiff could sue a trading advisor but could never be a plaintiff with standing to sue an exchange, because such plaintiff did not engage in any transaction on or subject to the rules of the exchange. In the alternative, a trader would have standing to sue a clearinghouse, if bad faith conduct by the clearinghouse caused the plaintiff's trading losses.

from the boards of trade and clearinghouses, and on to FCMs.[16] *See* Pet. at 14-19. Petitioner argues that these developments will adversely affect the national economy by increasing investors' trading costs. *Id.* Petitioner further argues that the "ruling below makes commodity exchanges unaccountable to futures commission merchants for bad faith violations of law." *Id.* at 17.

These concerns are highly speculative at best, but in any event they do not address the fact that Congress in the version of Section 22(b) in effect at the relevant time provided that standing was limited to "a person who engaged in any transaction on or subject to the rules of such contract market." 7 U.S.C. § 25(b)(1). Petitioner's assertion that the court of appeals' decision will have a profound adverse impact on the national economy falls flat, especially because Congress in late 2000 amended the statutory provision that Petitioner claims the court of appeals misconstrued.

In December 2000, Congress amended Section 22(b), and recast the category of persons with standing to bring an action under Section 22(b) to include those "who engaged in any transaction on or subject to the rules of such registered entit[ies]."[17] 7 U.S.C. § 25(b)(1) (2000). At the same time, Congress defined "registered entities" to include clearing organizations, like the NYCC. This amendment was not, as Petitioner contends, "merely technical." Pet. at 1 n.1. Rather, this amendment renders moot any general need to review the court of appeals' decision, because the decision's precedential significance is highly limited. Any FCM in an action commenced under the statute as revised in December 2000 may

[16] Of course, in this case, Klein's losses stemmed not from market risk but from customer credit risk.

[17] Similarly, 7 U.S.C. § 7(b)(3)(C), to which Klein cites to describe Congress' vision of the role of an FCM, *see* Pet. at 5, 22, was added in December 2000, *after* this action was commenced. Thus, it does not say anything about how Congress regarded FCMs prior to December 2000.

argue that its clearing activities are "subject to the rules of a registered entity" (which now include clearing organizations), and therefore can be the basis for a private right of action against a board of trade, contract market or clearing organization.[18]

Other policy arguments made by Petitioner are based on modern concerns, and are irrelevant, as they are advanced in support of Petitioner's strained interpretation of statutory language enacted by Congress twenty-five years ago. For example, the Petition states that "today" exchanges face conflicts of interest issues because, among other things, they must "generate returns for their owners." Pet. at 20. The circumstances that exist today, however, had no bearing on the scope of the private right of action that the 1982 Congress enacted in Section 22(b), at a time when virtually all commodity futures exchanges were not-for-profit membership organizations. Petitioner's policy arguments therefore have no substance, particularly because the statute at issue no longer provides what it did when this action was commenced.

Petitioner's final argument, that the court of appeals' decision absolves exchanges of liability for wrongdoing, ignores the role of the Commodity Futures Trading Commission (the "CFTC") in policing the futures industry. Enforcement of the CEA is the primary function of the CFTC. In fact, in 1982, at the same time it added CEA § 22, Congress enhanced the powers of the CFTC to take action against violations.[19] As demonstrated by the three separate proceed-

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[18] The NYBOT Respondents submit that the term "transaction" as used by Congress in the amended version of Section 22(b) is still limited to trades, and that Congress did not intend to broaden the categories of plaintiffs who could bring claims under the CEA to include clearing members who suffered credit losses.

[19] For example, in the case of contract markets and their officials, the CFTC was empowered in Sections 5b and 6(b) to suspend for six months and even terminate the designation of a contract market. *See* 7 U.S.C.

ings initiated by the CFTC in the wake of Petitioner's collapse, the CFTC's enforcement role served its appropriate function in this case.[20]

In sum, the precedential effect of the court of appeals' interpretation of the prior version of Section 22(b) is minimal. Standing for potential plaintiffs under the CEA is now governed by a revised version of the statute, and future plaintiffs must satisfy the standing requirements under the statute as amended. A decision so limited in scope is not a matter of importance requiring a writ of certiorari. For this reason as well, Klein's Petition should be denied.

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§§ 7b, 8 (1999). In Section 6b, the CFTC was empowered to impose fines against contract markets and their officials of up to $500,000 per violation and impose cease and desist orders. *See* 7 U.S.C. § 13a (1999). In Section 6c, the CFTC was empowered to bring court actions for injunctions and civil penalties in an amount equal to the greater of $100,000 or triple the monetary gain that resulted from the violation. *See* 7 U.S.C. § 13a-1 (1999).

[20] *See* Div. of Trading & Markets, *Report on Lessons Learned from the Failure of Klein & Co. Futures, Inc.* (C.F.T.C. July 2001), available at http://www.cftc.gov/files/tm/tmklein_report071101.pdf; Order Instituting Proceedings Pursuant to Section 5b, 6(b) and 6b of the Commodity Exch. Act, Making Findings and Imposing Remedial Sanctions, *In re New York Futures Exch., Inc.*, Docket No. 01-13 (C.F.T.C. July 11, 2001), available at http://www.cftc.gov/files/enf/01orders/enfnyfe.pdf; Order Making Findings and Imposing Remedial Sanctions, *In re Eisler & First West Trading, Inc.*, Docket No. 01-14 (C.F.T.C. Jan. 20, 2004), available at http://www.cftc.gov/files/enf/04orders/enfeisler-order.pdf.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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In The
# Supreme Court of the United States

KLEIN & CO. FUTURES, INC.,

*Petitioner,*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., ET AL.,

*Respondents.*

**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit**

## REPLY BRIEF FOR PETITIONER

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## REPLY BRIEF FOR PETITIONER

Respondents cannot defend the erroneous reading of the Commodity Exchange Act by the court of appeals that denied petitioner its private cause of action under 7 U.S.C. § 25(b)(1). Respondents also ignore their own malfeasance that caused millions of dollars of losses to petitioner and the investing public when they failed to enforce their rules and allowed the chairman of respondent New York Futures Exchange to manipulate prices and commit a fraud on the market. Congress vested petitioner and other similar FCMs with the Section 25(b)(1) claim precisely to recover actual losses caused by such a failure to enforce the rules which are necessary to ensure the financial stability of the market. Review and reversal by this Court is warranted to ensure that congressional purpose is achieved.

### A. Respondents Cannot Defend The Court Of Appeals' Erroneous Reading Of 7 U.S.C. § 25(b)(1)

1. The court of appeals explicitly and erroneously dismissed petitioner's claim under 7 U.S.C. § 25(b)(1) because petitioner did not meet the statutory standing requirements of a different cause of action set forth in 7 U.S.C. § 25(a)(1)(A)-(D). But Section 25(b)(1) includes no cross-reference to Section 25(a)(1) and, as the court of appeals elsewhere recognized, deals with entirely different claims. Pet. App. 7a-8a. The court of appeals thus violated a core principle of statutory construction: "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23 (1983) (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)).

Indeed, the court of appeals' reading of the statute is so plainly erroneous that summary reversal is urged by the *amicus* Futures Industry Association. *See* Br. of Futures Industry Association as *amicus curiae* at 8 (FIA *Amicus* Br.). Such an erroneous interpretation of a federal

statute governing billions of dollars of daily financial transactions merits review and reversal by this Court.

2. Unable to defend the basis of the court of appeals' dismissal of the Section 25(b)(1) claim for lack of statutory standing, respondents tacitly concede error below. *See* Br. in Opp. 19 (recognizing that Congress's "omission of a cross-reference" to Section 25(a)(1) has significance). They attempt to explain that the court of appeals' mistaken reasoning based on the fact that there were several different parties in the case and the court of appeals "did not distinguish with any precision" between them. Br. in Opp. 19.[1]

Respondents then attempt to construct an alternative rationale that they contend the court of appeals *could* have articulated to support its dismissal of the claim. They assert that 7 U.S.C. § 25(b)(1) confers no private right of action here because the court of appeals correctly held that petitioner, as a futures commission merchant (FCM) was nothing more than an agent for its customers and, therefore, did not actually trade, *i.e.*, *buy or sell*, commodities on its own behalf or for its own account. Respondents argue that petitioner therefore suffered only a credit loss and not a trading loss, which is what is necessary, in their view, to give rise to an action under 7 U.S.C. § 25(b)(1). *See, e.g.*, Br. in Opp. 16.

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[1] Respondents correctly point out (Br. in Opp. 18 n.14) that petitioner, in fact, appealed the case against all defendants to the Second Circuit. Their implication that that somehow alleviates the error of the court of appeals is wrong. The petition's reference to some of the defendants as non-appellees is irrelevant to the merits of the issue presented. It was based on a mistaken case caption below and the limited scope of the petition for rehearing, which in no way alters the error of the court of appeals because, as respondents also acknowledge and the petition pointed out, the defendants who were correctly captioned as appellees included a number of different types of defendants, including individuals, who were subject to suit under varying provisions of 7 U.S.C. § 25 that required the court to address different causes of action. And, as discussed above, the court of appeals clearly erred when it dismissed petitioner's Section 25(b)(1) cause of action for failure to meet the statutory standing requirements of Section 25(a) because, contrary to the court of appeals' ruling, those requirements do not apply to Section 25(b)(1).

Respondents are wrong on two scores. First, the text makes clear that statutory standing under Section 25(b)(1) is not limited, as respondents would have it, to some narrow "trader" or "buy or sell" notion. Rather, Congress unambiguously vested a private cause of action for actual losses under Section 25(b)(1) in "any person" who "engaged in any transaction" on or subject to the rules of a contract market.

Petitioner certainly was a person who engaged in transactions when it entered into the trading contracts at issue and cleared those contracts. And those transactions, no matter how respondents may characterize them, were "on or subject to the rules of" a contract market, because the Commodity Exchange Act so requires. *See* 7 U.S.C. § 6(a)(1). It was respondents' failure to enforce their rules that were designed to protect the financial integrity of such transactions which caused petitioner's loss.[2]

Second, even under respondents' mistaken paradigm of Section 25(b)(1) as limited to some narrower, nontextual

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[2] Respondents boldly ignore the fraud and market manipulation committed by the chairman of respondent New York Futures Exchange when they repeatedly insinuate that the collapse of petitioner's business was on account of a "customer" being unable to pay margin calls or some type of undercapitalization. Br. in Opp. i (counterstatement of question presented), 2, 5-6, 21 n.16. Respondents fail to note that the "customer" to whom they refer was the contract market's *own* chairman who manipulated the settlement prices of a futures contract, through his official position on the exchange's settlement committee, to create false profits and avoid margin calls, unbeknownst to petitioner, while respondents turned a blind eye. It was respondents' failure to enforce the rules to prevent that fraud and market manipulation that caused the loss. Moreover, petitioner was not undercapitalized. *See* Selected FCM Financial Data, *available at*, http://www.cftc.gov/tm/fcm/tmfcmdata0003.htm (last visited Apr. 26, 2007) (CFTC monthly report indicating that petitioner had six times the capital required by the CFTC before its failure). That petitioner's business failed, notwithstanding its excess capital, demonstrates the power that respondents possess when they wrongfully permit manipulation of the commodities market, as the CFTC found they did here, and underscores Congress's rationale for making respondents liable to petitioner for actual losses in the circumstances of this case.

"trader" or "buy or sell" requirement, the participation by FCMs such as petitioner in the types of transactions at issue is an integral part of any "trade." FCMs do not merely extend credit. This is true whether the FCM's transaction is viewed as trading on its own behalf (in light of the FCM's ultimate financial liability for the transaction, *see* Pet. 21-26) or on behalf of its customers (in light of the fact that the customers' margin payments are collected in an account *the FCM* holds with the contract market).[3]

Respondents' "agent or broker" argument that distinguishes between "trading" and "clearing" ignores how the commodities markets operate and have always operated. Contrary to respondents' unsubstantiated claim (Br. in Opp. 9), clearing *completes* the trade (*i.e.*, constitutes engaging in a transaction under Section 25(b)(1)). Indeed, if a purchase or sale is not "cleared," the trade does not and cannot occur.

The Commodity Futures Trading Commission, as the federal agency charged with regulation of this major financial industry, explicitly recognizes that "clearing" is "[t]he procedure through which the clearing organization becomes the buyer to each seller of a futures contract or other derivative, and the seller to each buyer for clearing members." CFTC, *Glossary*, *available at* http://www.cftc.gov/opa/glossary/opaglossary_c.htm (last visited Apr. 25, 2007). Moreover, the CFTC has explained that the "direct customers" of clearing organizations "are clearing FCMs [such as petitioner], not the FCMs' customers." Br. of CFTC as *Amicus Curiae*, *Board of Trade of the City of N.Y. v. Klein & Co. Futures, Inc.*, No. 01 Civ. 4071 (GBD), at 13 (Jul. 25, 2005); *see also In the Matter of W. Fin. Mgmt.*, CFTC No. 81-18, 1983 WL 29657 at *11 (C.F.T.C. Oct. 14, 1983) ("an FCM is the one who actually trades futures for

[3] Only clearing FCMs, such as petitioner, can trade on the futures exchanges. Because petitioner is a clearing FCM, no issues arise here regarding non-clearing FCMs which must use a clearing FCM to execute their trades.

the investing public"). As the agency charged with administration and enforcement of the statute, this CFTC interpretation of the functions of clearing organizations and FCMs is entitled to deference. *See CFTC v. Schor,* 478 U.S. 833, 844-845 (1986) (holding that CFTC's interpretation of CEA "must be accorded" "considerable weight," citing *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844-845 (1984)). These views of the CFTC reinforce the significance of the erroneous ruling below and the need for this Court's review.

3. Other courts of appeals, including the Seventh Circuit which is the other circuit in which futures exchange cases primarily arise, have correctly understood this role of FCMs under the Commodity Exchange Act. *See* Pet. 24-26. Unlike the Second Circuit below that reduced FCMs to the status of mere facilitators, other circuits have expressly held that, regardless of on whose behalf a FCM engages in a transaction, the contract of sale of a futures commodity is between clearing FCMs, not their customers. *See, e.g., Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179, 181 (7th Cir. 1984) (Posner, J.).

The best that respondents can do in their attempt to detract from this inconsistency with the Seventh Circuit is to assert that *Bernstein* is "outdated." Br. in Opp. 9. But the commodities markets operate today the same way they did when *Bernstein* was decided. Moreover, respondents provide no supporting citation to any statute, decision of this Court, or ruling of the Seventh Circuit that undermines the decision. *Bernstein* remains good law in the Seventh Circuit, which surely would have recognized the true role played by petitioner in this case that gave rise to the cause of action at issue.

Respondents' argument that petitioner is no different from the plaintiffs in *American Agriculture Movement, Inc. v. Board of Trade*, 977 F.2d 1147 (7th Cir. 1992), is patently incorrect. The plaintiffs in *American Agriculture Movement* were an association of soybean farmers and various of its members who had no connection with the futures industry and were affected by the exchange only

due to a drop in soybean prices. As such, they had not "engaged in any transaction on or subject to the rules" of a futures exchange; indeed, they had *no* contact at all with the exchange. The Seventh Circuit thus held, unremarkably, that such a non-market participant lacks standing. *Id.* at 1153.

Nothing in that opinion demonstrates that a FCM, who is properly understood by the Seventh Circuit and the CFTC to be a principal in futures transactions, is somehow not "engaged in" a "transaction on or subject to the rules" of a contract market. And, unlike the court of appeals below, the Seventh Circuit found it unnecessary and "not at issue" to address 7 U.S.C. § 25(a)(1)(A)-(D)'s requirements when addressing a claim under 7 U.S.C. § 25(b). *Id.* at 1152.[4]

## B. The Decision Below Is A Precedential Interpretation Of The Current Section 25(b)(1)

Respondents are wrong that the impact of the instant case can be limited because the case arose before the Commodity Exchange Act was amended in December 2000. Br. in Opp. 20-23.

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[4] Respondents misread the district court opinions they cite, as each is inapposite to the instant dispute. Br. in Opp. 8. *See DGM Investments, Inc. v. New York Futures Exchange, Inc.*, No. 01 Civ. 11602, 2002 WL 31356362, at *2-*4 (S.D.N.Y. Oct. 17, 2002) (complaint against exchange dismissed because bad faith not adequately alleged); *Vitanza v. Board of Trade of the City of New York*, No. 00 CV 7393, 2002 WL 424699, at *4-*6 (S.D.N.Y. Mar. 18, 2002) (claims dismissed against individual defendants under 7 U.S.C. § 25(b)(3) which expressly references and incorporates requirements of 7 U.S.C. § 25(a)(1)(A)-(D)'s requirements); *Unity House, Inc. v. First Commercial Financial Group*, No. 96C-1716, 1997 WL 701345, at *5-*7 (N.D. Ill. Nov. 5, 1997) (addressing claim raised under Section 25(a)(1)); *Atucha v. Commodity Exchange, Inc.*, 608 F. Supp. 510, 523 (S.D.N.Y. 1985) (dealing with plaintiff who lacked standing because he "placed trades * * * from a location in Argentina" so he thus fell "outside of the class of individuals who are protected by American commodities laws").

*First*, the court of appeals below explicitly decided the instant dispute under the current CEA, as amended. *See* FIA *Amicus* Br. 5. The Second Circuit understood that the amendment made no material difference and the court's erroneous interpretation of the federal statute as amended will govern future cases in the Second Circuit that involve Section 25, which "is precisely why the decision below has a continuing impact on the industry and why *amicus* is here." *Ibid.*

*Second*, the amendment to 7 U.S.C. § 25 was a "technical and conforming" amendment. H.R. Rep. No. 106-711, pt. 3, at 21-25, 60 (2000); H.R. Rep. No. 106-711, pt. 2, at 27-32, 72 (2000); H.R. Rep. No. 106-711, pt. 1, at 22-26, 41 (2000); Pet. 1 n.1; FIA *Amicus* Br. 5 (noting that amendment was not material). With regard to Section 25(b), Congress simply substituted the term "registered entity" in certain places where the terms "contract market," "clearing organization of a contract market" and "board of trade" previously appeared, and it added a definition of "registered entity" that includes "a board of trade designated as a contract market" and "a derivatives clearing organization," *i.e.*, a clearing organization of a contract market. 7 U.S.C. § 1a(29). Thus, the amendment did not alter the scope of petitioner's standing under Section 25(b)(1).

Respondents are wrong in their assertion that before the 2000 amendment "any transaction on or subject to the rules of such contract market," as set forth in Section 25(b)(1), did not then include a transaction subject to the rules of a clearinghouse. Br. in Opp. 14-15, 21-22. To the contrary, the rules of the contract market referenced there included the rules of its clearinghouse. Since 1976, well before the 1983 enactment of Section 25(b)(1), the CFTC's regulations have provided that, with respect to "contract market rules," "[t]he term contract market includes a clearing organization that clears trades for the contract market." 17 C.F.R. § 1.41(a)(3) (1999); *see also* 41 Fed. Reg. 40,091, 40,093 (Sept. 17, 1976) (CFTC explanation that "a meaningful distinction cannot be drawn between the rules of the clearing organization and the

contract market for purposes of" 7 U.S.C. § 7a); *see also* 7 U.S.C. § 25(b)(4) (1994) (confirming liability of clearing organization of a contract market under Section 25(b)(1) by expressly including in bad-faith provision a "clearing organization" that acts "in bad faith in failing to take action").

The current CEA similarly requires contract markets to establish and enforce clearing organization rules. *See* 7 U.S.C. § 7(d)(11) (board of trade designated as a contract market "shall establish and enforce rules providing for the financial integrity of any contracts traded on the contract market (*including the clearance and settlement of the transactions with a derivatives clearing organization*) * * * ") (emphasis added).[5]

*Third*, respondents' amendment argument would go only to the respondent clearing organization. It in no way could justify the court of appeals' dismissal of petitioner's Section 25(b)(1) claim against the other respondents, such as the New York Futures Exchange, which is a contract market that, even under respondents' reading, can be sued under either version of the statute.

### C. The Ruling Below Will Have A Profound Adverse Effect On The Commodity Futures Industry

1. Respondents' assertion that review is not warranted because this case is merely about the dismissal of a complaint "by one failed business" is nonsense. Br. in Opp. 20. The *amicus* Futures Industry Association explains that the decision below profoundly affects some of its most important members, including major financial firms such as Bear, Stearns & Co. Inc.; Calyon Financial Inc.; Citigroup Global Markets Inc.; Fimat USA LLC; Goldman, Sachs & Co.; J.P. Morgan Futures Inc.; Lehman

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[5] Respondents also defeat their own attempt to give importance to the 2000 technical amendment by asserting later in their brief (in a footnote) that the amended version of the statute "is still limited" and was not broadened to allow clearing members to bring claims. Br. in Opp. 22 n.18.

Brothers Inc.; Merrill Lynch Pierce Fenner & Smith Inc.; Morgan Stanley; and UBS. FIA *Amicus* Br. 6. All of these institutions are members of the Futures Industry Association and, under the decision below, each no longer has all the means intended by Congress to ensure that commodity exchanges comply with their rules, the Commodity Exchange Act, or the CFTC's regulations.

2. Respondents' suggestion that this Court need not review the case because they already have been investigated and sanctioned by the CFTC is similarly without merit. Sanction for their failure to enforce their rules that caused the losses at issue, while well deserved, does not obviate the need for a private suit by petitioner to recover its actual losses as explicitly authorized under the statute.

The CFTC relies upon contract markets to self-regulate, *see* 72 Fed. Reg. 6936 (Feb. 14, 2007) (to be codified at 17 C.F.R. pt. 38) (explaining the challenges faced by exchanges when self-regulating), which, in turn, requires private policing of those exchanges by the market participants most at risk, *i.e.*, the FCMs. In the underlying dispute, the CFTC's sanction of respondent NYFE imposed only a $75,000 penalty in part because NYFE also had "instituted procedures to improve its ability to secure compliance" with its own rules. *Matter of New York Futures Exchange, Inc.*, Docket No. 01-13, at 4 (C.F.T.C. July 11, 2001), *available at* http://www.cftc.gov/files/enf/01orders/enfnyfe.pdf (last visited Apr. 26, 2007). Particularly in such circumstances, the CFTC's limited monetary sanction in this case in 2001 (well before the erroneous rulings below) is best understood to reflect the agency's awareness that NYFE and the other respondents could be subjected to further suit by plaintiffs such as petitioner to recover actual losses. *See also id.* at 2 n.2 (NYFE and CFTC agreeing that CFTC finding of wrongdoing by respondents would not be binding "in any other proceeding").

Indeed, the CFTC's finding that the respondent contract market "failed to enforce NYFE Rule 315 * * * in violation of * * * 7 U.S.C. § 7a(8)," *Matter of New York*

*Futures Exchange, Inc.*, *supra*, at 4, reinforces the strength of petitioner's case and the need for this Court to review the judgment below that erroneously dismissed petitioner's Section 25(b)(1) claim for recovery of actual losses due to respondents' bad faith conduct. Although these actions of the CFTC speak for themselves, should there be any doubt as to the importance of this case, seeking the views of the Solicitor General of the United States would confirm the scope of harm to the financial integrity of the commodity futures market caused by respondents' failure to enforce their rules.

## CONCLUSION

For the foregoing reasons and the reasons set forth in the petition for a writ of certiorari, the petition should be granted.

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No. 06-1265

IN THE
# Supreme Court of the United States

KLEIN & CO. FUTURES INC.,

*Petitioner,*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., *ET AL.*,

*Respondents.*

**On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## BRIEF OF *AMICUS CURIAE* FUTURES INDUSTRY ASSOCIATION, INC. IN SUPPORT OF PETITIONER

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Pursuant to this Court's Rule 37.2, *amicus curiae* respectfully files this brief in support of the petition for certiorari.*

## STATEMENT OF INTEREST OF *AMICUS CURIAE*

The futures industry is a major engine of the American economy: every day, more than *$5 trillion* worth of futures contracts and related options are traded on the futures markets in this country. The Futures Industry Association (FIA) is a national trade association for that industry. Its regular membership consists of 35 of the Nation's largest futures brokerage firms, and its associate membership consists of approximately 150 firms involved in virtually all other segments of the industry. FIA regular members execute customer orders for, and provide the financial guarantees underwriting, more than 90% of all transactions on the United States futures markets. Petitioner Klein is not an FIA member; respondents Board of Trade of the City of New York and New York Clearing Corporation are associate members. Neither regular nor associate members are bound by the views taken by FIA as *amicus*.

FIA has a strong interest in any case that affects the futures industry, and has participated as *amicus curiae* in several such cases, including *eBay, Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 733 (2005), *Dunn v. CFTC*, 519 U.S. 465 (1997), and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982). FIA has a particularly strong interest in cases involving the interpretation of the Commodity Exchange Act (CEA), the federal statute that

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* Pursuant to this Court's Rule 37.6, *amicus* states that no counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus* has made a monetary contribution to the preparation or submission of this brief. All parties have consented to the filing of this brief *amicus curiae*, and their consent letters are on file with the Clerk's Office.

establishes the regulatory framework governing the futures industry and the relevant regulatory agency, the Commodity Futures Trading Commission (CFTC).

This case presents such an issue. As explained below, the Second Circuit clearly misinterpreted the CEA's plain language to deprive futures commission merchants like petitioner of any cause of action against registered entities like respondents New York Futures Exchange, Inc., Board of Trade of the City of New York, and New York Clearing Corporation. That error affects the interests not only of the parties to this case, but of the entire futures industry, by exposing futures commission merchants to substantial financial harm resulting from bad faith misconduct by registered entities without any remedy. Because that decision threatens to destabilize those firms whose funds provide the financial backbone for this important industry, FIA sought (and obtained) leave to file a brief *amicus curiae* in the Second Circuit in support of the petition for rehearing and rehearing *en banc*, and now files this brief in support of the petition for certiorari.

## REASON FOR GRANTING THE WRIT

### The Second Circuit Clearly Erred, And Destabilized The Nation's Futures Industry, By Stripping Futures Commission Merchants Of Their Statutory Cause Of Action Against Registered Entities.

As a threshold matter, there can be no real dispute that the Second Circuit erred by construing the CEA to deprive futures commission merchants like petitioner of a cause of action against registered entities like respondents New York Futures Exchange, Inc., the Board of Trade of the City of New York, and New York Clearing Corporation. Such a cause of action is expressly conferred by Section 22 of the CEA, codified at 7 U.S.C. § 25, which authorizes claims against "[a] registered entity that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce" by "a person who engaged in any

transaction on or subject to the rules of such registered entity to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions." *Id.* § 25(b)(1).

That is the beginning and the end of this case. Respondents New York Futures Exchange, Inc., Board of Trade of the City of New York, and New York Clearing Corporation are "registered entit[ies]." *See id.* § 1a(29) (defining "registered entity" to include "a board of trade designated as a contract market" and "a derivatives clearing organization"). Petitioner is "a person who engaged in any transaction on or subject to the rules of such registered entit[ies]," *id.* § 25(b)(1); indeed, petitioner engaged in transactions subject to the rules of no fewer than *three* "registered entit[ies]," respondents Board of Trade of the City of New York, New York Futures Exchange, and New York Clearing Corporation. Petitioner alleges that respondents "fail[ed] to enforce any bylaw, rule, regulation, or resolution that [they are] required to enforce," and that as a result petitioner suffered "actual losses ... caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions." *Id.*

The Second Circuit could not, and did not, deny any of these straightforward points. Rather, the Second Circuit began its analysis by correctly noting that "Section 22 includes two types of claims": "Section 22(a) relates to claims against persons *other* than registered entities and registered futures associations," whereas "Section 22(b) deals with claims against [registered] entities and their officers, directors, governors, committee members and employees." Pet. App. 7a (emphasis added; citing 7 U.S.C. §§ 25(a), (b)). This case, as the Second Circuit recognized, involves a Section 22(b) claim: petitioner is suing registered entities and individuals affiliated with those entities. *See* Pet. App. 8-9a; 11a. Such a claim, as the Second Circuit again recognized, is "available only to

a private litigant 'who engaged in ... transaction[s] on or subject to the rules of a contract market.'" Pet. App. 8a (quoting 25 U.S.C. § 25(b)(1)-(3)).

The Second Circuit, however, never analyzed the critical issue whether petitioner is "a person who engaged in any transaction on or subject to the rules of" a contract market or other registered entity, 7 U.S.C. § 25(b)(1), within the meaning of Section 22(b). Instead, the Second Circuit simply assumed without analysis that a person pursuing a claim under Section *22(b)* is subject to the limitations applicable to a person pursuing a claim under Section *22(a)*. *See* Pet. App. 7-8a ("The text of the two subdivisions requires that a putative plaintiff fall within one of the four required relationships set forth in § 22(a)(1)(A-D)."); Pet. App. 9a ("[Petitioner] does not fall within any of the required subdivisions of § 22(a)(1)(A)-(D).").

That is a complete non sequitur. Sections 22(a) and (b) create different causes of action by different plaintiffs against different defendants. Section 22(a) creates a cause of action against non-registered entities (*i.e.*, intermediaries like traders and brokers), *see* 7 U.S.C. § 25(a), whereas Section 22(b) creates a cause of action against registered entities, including futures contract markets, *see id.* § 25(b). The requirements of the cause of action under Section 22(a) are set forth in Section 22(a), while the requirements for the cause of action under Section 22(b) are set forth in Section 22(b). Nothing in the statute remotely purports to import the requirements for a Section 22(a) claim into Section 22(b), and there is no basis in law or logic for doing so. *See, e.g., Russello v. United States*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.") (internal citation omitted); *see also Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co., Ltd.*, 484 U.S. 97, 106 (1987)

(applying this principle to the CEA). The wholesale importation of Section 22(a) requirements into Section 22(b) is especially problematic because specific provisions of Section 22(b) expressly incorporate the provisions of Section 22(a), underscoring that Congress knew perfectly well how to accomplish such incorporation where it wished to do so. *See* 7 U.S.C. § 25(b)(2) (referring to "a person that engaged in any transaction specified in subsection (a) of this section"); *id.* § 25(b)(3) (same).

The Second Circuit did not dispute any of the foregoing canons of interpretation, or otherwise seek to justify its importation of Section 22(a)'s requirements into Section 22(b). Rather, the court appears to have taken that fateful step wholly by inadvertence. Needless to say, that is no way to construe any statute, much less the statute governing one of the most important industries in this Nation. If the Second Circuit had a reason for importing Section 22(a)'s requirements into Section 22(b), the court at a minimum should have disclosed that reason.

Respondents tried to confuse matters at the rehearing stage below by arguing that this case is governed by statutory provisions that were amended in 2000. But the 2000 amendments invoked by respondents did not alter the statute in any way material here: in relevant part, those amendments substituted the term "registered entity" for the previous term "contract market," but under settled pre-2000 law, each respondent that is now a "registered entity" was covered by the term "contract market." *Compare* 7 U.S.C. § 25(b)(1) (2007 ed.) with 7 U.S.C. § 25(b)(1) (1994 ed.). In any event, notwithstanding respondents' theory that this case should be decided under the pre-2000 statute, the Second Circuit clearly decided the case under the post-2000 statute, *see* Pet. App. 7-9a & nn.3, 4, which is precisely why the decision below has a continuing impact on the industry and why *amicus* is here.

The petition well explains how the Second Circuit's erroneous conception of the role of futures commission merchants conflicts with the understanding of the other circuit in which CEA cases tend to arise, the Seventh Circuit (which is home to the Nation's two largest futures exchanges, the Chicago Board of Trade and the Chicago Mercantile Exchange). *See* Pet. 23-25. But above and beyond that conflict, the petition warrants review (and possible summary reversal) given its impact on the stability of the Nation's futures markets.

To understand the gravity of the Second Circuit's error, it is necessary to understand the basic operation of the futures and related options markets. Individual customers generally do not buy or sell directly in those markets; rather, they necessarily carry out their transactions through a futures commission merchant, like petitioner here. The best capitalized of these merchants become "clearing firms" that deposit over $50 billion daily with clearing houses, like respondent New York Clearing Corporation, to ensure against defaults. Such clearing firms include some of the Nation's best-known financial institutions, such as Bear, Stearns & Co. Inc., Calyon Financial Inc., Citigroup Global Markets Inc., Fimat USA LLC, Goldman, Sachs & Co., J.P. Morgan Futures Inc., Lehman Brothers Inc., Merrill Lynch Pierce Fenner & Smith Inc., Morgan Stanley, and UBS.

The Second Circuit displayed a fundamental misunderstanding of the industry by asserting that futures commission merchants like petitioner have "no financial interest" in their trades, and do not "face[] essentially the same risks as a buyer or seller of commodities contracts." Pet. App. 12a. To the contrary, as this Court has recognized, such merchants are "essential participants" in futures markets precisely because they are required to guarantee their customers' performance and to honor the contracts if their customers default. *Curran*, 456 U.S. at 359-60; *see also Leist v. Simplot*, 638 F.2d 283, 287 (2d Cir. 1980) (Friendly, J.)

(describing futures commission merchants as "principals in trading transactions").

Because a futures commission merchant guarantees its customers' performance, it makes perfect sense for Congress to have given such merchants (as well as their customers) a cause of action against registered entities that cause them losses as a result of bad-faith misconduct. Indeed, this case underscores why it would make no sense to limit the cause of action to customers, since the customer here (Norman Eisler, then chairman of the New York Futures Exchange) is the very person who allegedly abused his exchange office to manipulate market prices and then defaulted on his obligations. *See* Pet. 9-11. Precisely because petitioner was required to honor the contracts it entered on Eisler's behalf, it suffered massive losses (and indeed was forced out of business) after Eisler defaulted. Given the financial liability of futures commission merchants in futures transactions, the futures markets in this Nation will be seriously undermined if such merchants can be left holding the bag as the result of bad faith misconduct committed by officials of registered entities.

The decision below, in flat disregard of Section 22(b), shifted the financial risk of misconduct away from the registered entities charged with enforcing the rules onto the futures commission merchants that are engaged in every futures transaction, thereby creating a disincentive for these firms to underwrite the very speculation and risk-taking upon which the futures markets depend. *See, e.g., Curran*, 456 U.S. at 359-60 (noting that futures commission merchants "have an interest in maximizing the activity on the exchange"). If futures commission merchants are left without any meaningful recourse for losses caused by bad faith misconduct by registered entities, they will be less willing to risk their capital to finance needed trading activity. Since futures commission merchants are engaged in every transaction in the futures markets, this reluctance could decrease the

overall liquidity and depth of those markets, and result in greater fluctuations in the prices of basic commodities contrary to the national interest. *See, e.g.*, *id.* at 358.

Given that the decision below is indefensible as a matter of law and disastrous as a matter of policy, this Court should not allow the decision to stand. Accordingly, this Court should grant the petition and either set the case for plenary review or summarily reverse the decision below. At the very least, this Court should call for the views of the Solicitor General, who can speak for the CFTC on this issue of vital importance to such an important segment of the Nation's economy.

## CONCLUSION

For the foregoing reasons, this Court should grant the petition for writ of certiorari, and either set the case for plenary review or summarily reverse the decision below.

Respectfully submitted,

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**On Writ Of Certiorari To The
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## JOINT APPENDIX

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## RELEVANT DOCKET ENTRIES

### U.S. District Court
### Southern District of New York (Foley Square)
### CIVIL DOCKET FOR CASE #: 1:00-cv-05563-GBD

* * *

| Date Filed | # | Docket Text |
|---|---|---|
| 07/26/2000 | 1 | COMPLAINT filed. Summons issued and Notice pursuant to 28 U.S.C. 636(c). FILING FEE $150.00. RECEIPT #379739. (em) (Entered: 07/27/2000) |
| | | * * * |
| 10/16/2000 | 8 | NOTICE OF MOTION by Board of Trade NYC, New York Cotton Exch, New York Futures, N.Y. Clearing Corp., Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peres, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Hitesh Trivedi, Joseph O'Neill, Walter Fair, Evan Thomas, Joseph Jach (collectively, the "NYBOT" defts) to dismiss Counts I through III of the complaint as against the NYBOT defts for failure to state a claim upon which relif [sic] can be granted, purs to FRCP 12(b)(6); to dismiss Counts IV through XI of the complaint as against defts for lack of subject matter jurisdiction, or in the alternative, dismissing Counts IV through XI of the complaint purs to FRCP 12(b)(1) and 28 U.S.C. 1367 and FRCP 12(b)(6); to dismiss Counts II and VII of the complaint as against the NYBOT defts. With affidavit in support of Howard R. Hawkins, Jr. attached. Return date 12/19/00 @ 10:00 am. (lam) Modified on 10/18/2000 (Entered: 10/18/2000) |

| | | |
|---|---|---|
| 10/16/2000 | 9 | MEMORANDUM OF LAW by Board of Trade NYC, New York Cotton Exch, New York Futures, N.Y. Clearing Corp., Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peres, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Hitesh Trivedi, Joseph O'Neill, Walter Fair, Evan Thomas, Joseph Jach in support of [8-1] motion to dismiss Counts I through III of the complaint as against the NYBOT defts for failure to state a claim upon which relief can be granted, purs to FRCP 12(b)(6), [8-2] motion to dismiss Counts IV through XI of the complaint as against defts for lack of subject matter jurisdiction, or in the alternative, dismissing Counts IV through XI of the complaint purs to FRCP 12(b)(1) and 28 U.S.C. 1367 and FRCP 12(b)(6), [8-3] motion to dismiss Counts II and VII of the complaint as against the NYBOT defts. (lam) (Entered: 10/18/2000) |
| 10/18/2000 | 10 | NOTICE OF MOTION by First West Trading, Norman Eisler to dismiss for lack of jurisdiction purs to Rule 12(b)(1) and 12(h)(3) of the FRCP; Return date 12/19/00. Attached is Affidavit in Support. (djc) (Entered: 10/19/2000) |
| 10/18/2000 | 11 | MEMORANDUM OF LAW by First West Trading, Norman Eisler in support of [10-1] motion to dismiss for lack of jurisdiction purs to Rule 12(b)(1) and 12(h)(3) of the FRCP. (djc) (Entered: 10/19/2000) |
| 12/05/2000 | 12 | MEMORANDUM OF LAW by Klein & Co. Futures in opposition to Eisler defts' [10-1] motion to dismiss for lack of jurisdiction purs to Rule 12(b)(1) and 12(h)(3) of the FRCP. (lam) (Entered: 12/06/2000) |

12/05/2000 13 AFFIDAVIT of Mark H. Alonso, atty for Klein & Co. Futures in opposition to [10-1] motion to dismiss for lack of jurisdiction purs to Rule 12(b)(1) and 12(h)(3) of the FRCP. (lam) (Entered: 12/06/2000)

12/05/2000 14 MEMORANDUM OF LAW by Klein & Co. Futures in opposition to NYBOT defts' [8-1] motion to dismiss Counts I through III of the complaint as against the NYBOT defts for failure to state a claim upon which relif [sic] can be granted, purs to FRCP 12(b)(6), [8-2] motion to dismiss Counts IV through XI of the complaint as against defts for lack of subject matter jurisdiction, or in the alternative, dismissing Counts IV through XI of the complaint purs to FRCP 12(b)(1) and 28 U.S.C. 1367 and FRCP 12(b)(6), [8-3] motion to dismiss Counts II and VII of the complaint as against the NYBOT defts. (lam) (Entered: 12/06/2000)

12/05/2000 15 AFFIDAVIT of Mark J. Alonso, atty for Klein & Co. Futures in opposition to [8-1] motion to dismiss Counts I through III of the complaint as against the NYBOT defts for failure to state a claim upon which relif [sic] can be granted, purs to FRCP 12(b)(6), [8-2] motion to dismiss Counts IV through XI of the complaint as against defts for lack of subject matter jurisdiction, or in the alternative, dismissing Counts IV through XI of the complaint purs to FRCP 12(b)(1) and 28 U.S.C. 1367 and FRCP 12(b)(6), [8-3] motion to dismiss Counts II and VII of the complaint as against the NYBOT defts. (lam) (Entered: 12/06/2000)

12/18/2000 16 REPLY MEMORANDUM by the NYBOT defts in further support of their [8-1] motion to dismiss Counts I through III of the complaint as against NYBOT defts for failure to state a claim upon which relif [sic] can be granted, purs to FRCP 12(b)(6), [8-2] motion to dismiss Counts IV through XI of the complaint as against defts for lack of subject matter jurisdiction, or in the alternative, dismissing Counts IV through XI of the complaint purs to FRCP 12(b)(1) and 28 U.S.C. 1367 and FRCP 12(b)(6), [8-3] motion to dismiss Counts II and VII of the complaint as against the NYBOT defts (lam) (Entered: 12/19/2000)

12/19/2000 17 REPLY MEMORANDUM by First West Trading, and Norman Eisler in support of re: [10-1] motion to dismiss for lack of jurisdiction purs to Rule 12(b)(1) and 12(h)(3) of the FRCP. (kw) (Entered: 12/20/2000)

* * *

03/02/2001 20 Transcript of record of proceedings before Judge George B. Daniels for the date(s) of 1/17/01 @ 11:30am. (lam) (Entered: 03/02/2001)

* * *

02/18/2005 22 ORDER: for reasons further set forth in said Order, NYBOT's [8], and First West & Eisler's [10] motions to dismiss Klein's complaint in Klein I (00 Civ. 5563) is GRANTED. NYBOT and NYCC motion for judgment on the pleadings in Klein II (01 Civ. 4071) is DENIED. NYBOT and NYCC motion to dismiss Klein's counterclaims in Klein II (01 Civ. 4071) is GRANTED.. (Signed by Judge George B. Daniels on 2/18/05) (db,) Modified on 2/25/2005 (tr,). (Entered: 02/18/2005)

03/03/2005 23 CLERK'S JUDGMENT that for the reasons stated in the Court's Memorandum Decision and Order, dated Feb 18, 2005, defts' motion for summary judgment is granted dismissing the complaint in Klein I, NYBOT and NYCC's motion to dismiss the counterclaims in Klein II is denied; and NYBOT and NYCC's motion for judgment on the pleadings is denied. (Signed by J. Michael McMahon, Clerk on 3/3/05) (jf,) (Entered: 03/03/2005)

* * *

03/15/2005 25 NOTICE OF APPEAL from [22] Order on Motion to Dismiss/Lack of Jurisdiction,,,,,,,. Document filed by Klein & Co. Futures, Inc.. Filing fee $ 255.00, receipt number E 537474. Copies of Notice of Appeal mailed to Attorney(s) of Record: Howard R. Hawkins, Gary D. Stumpp. (pr,) (Entered: 03/15/2005)

* * *

03/17/2005 26 CORRECTED CLERK'S JUDGMENT That for the reasons stated in the Court?s [sic] Memorandum Decision and Order dated February 18, 2005, NYBOT, First West and Eisler's motion to dismiss Klein?s [sic] complaint in Klein I (00 Civ. 5563) is granted and the complaint is dismissed; NYBOT and NYCC's motion for judgment on the pleadings in Klein II (00 Civ. 4701) is denied; and NYBOT and NYCC's motion to dismiss Klein?s [sic] counterclaims in Klein II (00 Civ. 4071) is granted. (Signed by J. Michael McMahon, clerk on 3/17/05) (ml,) (Entered: 03/17/2005)

| | | |
|---|---|---|
| 03/21/2005 | 27 | SECOND CORRECTED CLERK'S JUDGMENT THAT for the reasons stated in the Court's Memorandum Decision dated Feb. 8, 2005, NYBOT, First West and Eisler's motion to dismiss Klein's complaint in Klein I (oo Cv 5563) [sic] is granted and the complaint is dismissed; NYBOT and NYCC's motion for judgment on the pleadings in Klein II (01 Cv 4071) is denied; and NYBOT and NYCC's motion to dismiss Klein's counterclaims in Klein II(01 Cv 4071) is granted.. (Signed J. Michael McMahon, Clerk on 3/21/05 (jf,) (Entered: 03/21/2005) |

* * *

**General Docket**

**U.S. Court of Appeals for the Second Circuit**

* * *

9/18/06 Judgment of the district court is AFFIRMED by published signed opinion filed. (BDP) [Entry date Sep 18 2006] [AM]

9/18/06 Judgment filed. [Entry date Sep 18 2006] [AM]

* * *

10/2/06 Appellant Klein & Co. Futures, Inc. Petition for rehearing and petition for rehearing en banc filed with proof of service. [Entry date Oct 16 2006] [AM]

* * *

10/11/06 Movant Futures Industry Association motion to file brief as amicus curiae in support of petition for rehearing filed with proof of service. [Entry date Oct 12 2006] [AM]

* * *

10/20/06 AMICUS CURIAE Futures Industry Association, response to the petition for rehearing with proof of service FILED. [Entry date Oct 20 2006] [AM]

* * *

10/20/06 Order FILED GRANTING motion to file brief as amicus curiae by Movant Futures Industry Association, endorsed on motion dated 10/11/2006. (Before: BDP, CJ., By: AH) [Entry date Oct 20 2006] [AM]

* * *

11/14/06 Order FILED DENYING Petition for rehearing by Appellant Klein & Co. Futures, Inc., endorsed on motion dated 10/11/2006, Order FILED DENYING petition for rehearing en banc by Appellant Klein & Co. Futures, Inc., endorsed on motion dated 10/11/2006. (AH) [Entry date Nov 15 2006] [AM]

* * *

5/25/07 Writ of Certiorari GRANTED. [Entry date Jun 1 2007] [AM]

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------X

KLEIN & CO. FUTURES, INC.,

Plaintiff,

-against-

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., FIRST WEST TRADING, INC., NORMAN EISLER, MARK D. FICHTEL, ALBERT WEIS, JEFF SOMAN, CHARLES SWEENEY, AL PERES, CHRIS MEEK and "JOHN DOE" 1 through 10, NEW YORK CLEARING CORPORATION, GEORGE HAASE, LAWRENCE GULITTI, BRYAN SAYLER, HITESH TRIVEDI, and "RICHARD ROE" 1 THROUGH 10, NEW YORK COTTON EXCHANGE, INC., NEW YORK FUTURES EXCHANGE, INC., JOSEPH O'NEILL, WALTER FAIR, EVAN THOMAS, JOSEPH JACH and "PETER POE" 1 through 10.

Defendants,

----------X

Case #

COMPLAINT

00 CIV. 5563

Plaintiff Klein & Co. Futures, Inc., by its attorneys, Alonso, Ferrigno & Andalkar, P.C., as and for its complaint against the defendants, alleges and sets forth as follows:

## JURISDICTION AND VENUE

1. The Court has jurisdiction over this case pursuant to 28 U.S.C.A. § 1331, in that this action arises under the laws of the United States, more particularly, the Commodities Exchange Act ["CEA"] and the Code of Federal Regulation ["C.F.R."], as hereinafter more fully appears. Because they arise under the same set of facts and transactions, this Court may exercise pendent jurisdiction over the common law claims asserted by Plaintiff.

2. Venue is properly lodged in this Court, pursuant to 28 U.S.C. § 1391(b) and 7 U.S.C. § 25(c). Plaintiff and Defendants reside and are found in this District, and a substantial part of the events or omissions giving rise to the claims herein occurred in this District.

## THE PARTIES AND COMMON ALLEGATIONS

3. Plaintiff Klein & Co. Futures, Inc., [hereinafter referred to as "Klein & Co."] is a New York corporation with its principal place of business located at 90 West Street, New York, NY 10006. Klein & Co. is a Futures Commission Merchant ["FCM"] and provides other financial services.

4. Upon information and belief, Defendant First West Trading, Inc. [hereinafter "First West"] is a New York corporation with its principal place of business at 4 Pinebrook Drive, White Plains, NY 10605. First West is in the business of trading commodities and is a customer of Plaintiff Klein & Co.

5. Upon information and belief, Defendant Norman Eisler is [hereinafter "Eisler"] is [sic] an adult individual

whose last known address is 4 Pinebrook Drive, White Plains, NY 10605.

6. Upon information and belief, Eisler is a principal of First West.

7. At all times relevant hereto, Eisler was the chairman of the New York Futures Exchange, Inc. and on the Settlement Committee for Pacific Stock Exchange Technology Index Futures Contract and Options thereon [hereinafter "P-Tech Futures and Options"].

8. A Settlement Committee for a contract (i.e. a commodity) is, *inter alia,* responsible, using an arithmetic formula, for calculating the settlement price of a particular contract or option.

9. P-Tech Futures and Options is a composite index of one hundred tech stocks compiled by the Pacific Stock Exchange.

10. At all times relevant herein, Eisler was responsible for the calculation of the settlement price of P-Tech Futures and Options, upon information and belief, by himself or in conjunction with other members of P-Tech Futures and Options Settlement Committee.

11. Defendant Board of Trade of the City of New York, Inc. [hereinafter "NYBOT"] is a New York not-for-profit corporation with its principal place of business in the City, County and State of New York.

12. NYBOT is a board of trade created and operating pursuant to various laws and regulations, including, but not limited to, the CEA. NYBOT maintains contract markets for the trading of futures contracts and options in

commodities such as coffee, sugar, cocoa, cotton, and financial products by public customers and other entities.

13. Upon information and belief, defendant Mark D. Fichtel [hereinafter "Fichtel"] is an adult individual, doing business in the City, County and State of New York.

14. At all times relevant hereto, Fichtel was the President and Chief Executive Officer of the NYBOT.

15. Upon information and belief, Defendant Albert Weis [hereinafter "Weis"] is an adult individual doing business in the City, County and State of New York.

16. At all times relevant hereto, Weis was the Chairman of the NYBOT.

17. Defendants John Does 1 through 10 are Board members of the NYBOT who have not heretofore been named, but who have taken actions similar or identical to those of the other individual defendants.

18. Defendants Fichtel, Weis, and John Doe 1 through 10 shall hereinafter be collectively referred to as "NYBOT Board."

19. Upon information and belief, Defendant New York Clearing Corporation [hereinafter "NYCC"] is a New York corporation, with its principal place of business in the City, County and State of New York. Although a separate corporate entity, NYCC is owned and/or controlled by NYBOT and/or by the same persons or entities which control NYBOT.

20. NYCC clears all trades transacted on NYBOT and, *inter alia*, is responsible for assuring that all such trades are properly consummated.

21. Upon information and belief, defendant George Haase [hereinafter "Haase"] is an adult individual doing business in the City, County and State of New York.

22. At all time [sic] relevant hereto, Haase was the President of the NYCC and, upon information and belief, a board member thereof.

23. Upon information and belief, defendant Lawrence Gulitti [hereinafter "Gulitti"] is an adult individual doing business in the City, County and State of New York.

24. At all times relevant hereto, Gulitti was the Senior Vice President of the NYCC.

25. Upon information and belief, defendant Bryan Sayler [hereinafter "Sayler"] is an adult individual doing business in the City, County and State of New York.

26. At all times relevant hereto, Sayler was the Vice President of the NYCC.

27. Upon information and belief, defendant Hitesh Trivedi [hereinafter "Trivedi"] is an adult individual doing business in the City, County and State of New York.

28. At all times relevant hereto, Trivedi was an Assistant Vice President of the NYCC.

29. Upon information and belief, defendants Richard Roe 1 through 10 are members of the board of the NYCC that have not heretofore been named, but served as board members at all times relevant hereto.

30. Defendants Haase, Gulliti, Sayler, Trivedi, and Richard Roe 1 through 10 are hereinafter collectively referred to as the "NYCC Board."

31. Upon information and belief, Defendant New York Cotton Exchange, Inc., [hereinafter the "Cotton Exchange"] is a New York corporation with its principal place of business in the City, County and State of New York.

32. Upon information and belief, Cotton Exchange is the parent corporation of the New York Futures Exchange, Inc.

33. Defendant New York Futures Exchange, Inc., [hereinafter "NYFE"] is a New York corporation, with its principal place of business in the City, County and State of New York.

34. NYFE is a contract market that has been designated by the Commodity Futures Trading Commission to serve as a market for the trading of various commodity futures and options thereon, including, but not limited to P-Tech Futures and Options.

35. In order for NYFE to be designated as a contract market to trade the commodities alleged herein, certain conditions must exist for such designation and must be met on an ongoing basis as follows:

(a) The governing board must provide for prevention of dissemination by the board or any member thereof of false or misleading or knowingly inaccurate reports conditions that affect or tend to affect the price of any commodity in interstate commerce.

(b) The governing board must provide for the prevention of manipulation of prices and the cornering of any commodity by the dealers or operators upon such board.

(c) The governing board must ensure that transactions within the contract market are not contrary to the public interest.

36. Upon information and belief, defendant Joseph O'Neill [hereinafter "O'Neill"] is an adult individual doing business in the City, County and State of New York and residing in the County of Nassau, State of New York.

37. At all times relevant hereto, O'Neill was the Executive Vice-President/President-Financial Products of the NYBOT. O'Neill was, *inter alia*, responsible for the financial products of NYBOT and NYFE, including, but not limited to, the P-Tech Futures and Options Index.

38. Upon information and belief, Defendant Jeff Soman [hereinafter "Soman") is an adult individual doing business in the City, County and State of New York.

39. At all times relevant hereto, Soman was a board member of the New York Futures Exchange, Inc.. [sic]

40. Upon information and belief, defendant Charles Sweeney [hereinafter "Sweeney"] is an adult individual doing business in the City, County and State of New York.

41. At all times relevant hereto, Sweeney was a board member of the New York Futures Exchange, Inc.

42. Upon information and belief, defendant Al Peres [hereinafter "Peres"] is an adult individual doing business in the City, County and State of New York.

43. At all times relevant hereto, Peres was a board member of the New York Futures Exchange, Inc.

44. Upon information and belief, defendant Chris Meek [hereinafter "Meek"] is an adult individual doing business in the City, County and State of New York.

45. At all times relevant hereto, Meek was a board member of the New York Futures Exchange, Inc. Meek, Soman and Sweeney shall hereinafter be referred to as the "NYFE Board."

46. Upon information and belief, defendant Walter Fair [hereinafter "Fair"] is an adult individual, doing business in the City, County and State of New York.

47. At all time relevant hereto, Fair was a member of the P-Tech Futures and Options Settlement Committee.

48. Upon information and belief, defendant Evan Thomas [hereinafter "Thomas"] is an adult individual doing business in the City. County and State of New York.

49. At all time relevant hereto, Thomas was a member of the P-Tech Futures and Options Settlement Committee.

50. Upon information and belief, defendant Joseph Jach [hereinafter "Jach"], is an adult individual doing business in the City, County and State of New York.

51. At all time relevant hereto, Jach was a member of the P-Tech Futures and Options Settlement Committee.

52. Upon information and belief, defendants Peter Poe 1 through 10 are members of the P-Tech Futures and Options Settlement Committee who have not heretofore been named but served on the P-Tech Futures and Options Settlement Committee at all times relevant hereto.

53. Defendants Eisler, Fair, Thomas, Jach and Peter Poe 1 through 10 are hereinafter collectively referred to as "P-Tech Futures and Options Settlement Committee."

54. Defendants NYBOT, the NYBOT Board, NYCC, NYCC Board, Cotton Exchange, NYFE and P-Tech Futures and Options Settlement Committee have a quasi-governmental role in managing, operating and trading of contract markets (i.e. commodities market). As such, they *inter alia,* regulate the industry, conduct investigations, provide an orderly, fair market for the contract markets within their purview. All defendants except First West shall hereinafter be referred to as the "Industry Defendants."

55. Defendant First West was a long-term customer of Klein & Co. assigned account number 05-09489. First West purchased and sold, among other things, contracts in P-Tech Futures and Options from the inception of the P-Tech Futures and Options contract market in or about April of 1996 until May 15, 2000.

56. At all times relevant hereto, Eisler effected unsolicited trades for the account of First West, without input, counsel, advice or any type of recommendation whatsoever from Klein & Co.

57. Klein & Co. had no equity or financial interest in the First West account nor did Klein & Co. exercise control over the trading in said account.

58. During this time, Eisler and the P-Tech Futures and Options Settlement Committee, under the supervision and direction of the other Industry Defendants and the employees thereof, were responsible for formulating, setting and publishing the settlement price of P-Tech

Futures and Options. The settlement price determines the price/value of an individual contract as used, *inter alia*, to calculate margin requirements in customers' accounts.

59. Eisler, through First West and in the First West account, entered into transactions of numerous P-Tech Futures and Options Contracts.

60. Upon information and belief, Eisler and the P-Tech Futures and Options Settlement Committee, either intentionally, or acting in bad faith with gross negligence and recklessness so egregious as to constitute a danger and harm to the public, grossly miscalculated the settlement price of P-Tech Futures and Options.

61. The incorrect information regarding the settlement price was disseminated by NYBOT and was used by Klein & Co. to calculate margin requirements applicable to First West's account and by other clearing members to calculate margin requirements applicable to their customers' accounts.

62. This miscalculation of the P-Tech Settlement Price, during the period commencing on an unknown date earlier than March, 2000 and continuing through on or about May 15, 2000 caused the margin calculations for First West's account to be incorrect.

63. Upon information and belief, prior to 1999, all responsibility for supervision, regulation. investigation and certain other quasi-governmental duties of the NYFE were delegated to NYBOT and NYBOT assumed such duties and responsibilities.

64. Upon information and belief, commencing in or about March, 2000, if not earlier, the Industry Defendants received or became aware of complaints from various

individuals in the industry including, but not limited to floor trading members of NYFE, regarding the P-Tech Futures and Options Settlement Committee's miscalculation of the P-Tech Futures and Options Settlement Prices.

65. Upon information and belief, at or about the time that the complaints were received, two clearing member companies, Saul Stone & Co., L.L.C. ["Saul Stone"] and Spear Leeds & Kellogg [hereinafter "SLK"], both of whom had officers of their respective companies on the NYFE board, ceased to effect transactions in P-Tech Futures and Options and, upon information and belief, SLK thereafter refused to accept orders from customers to do so.

66. Hull Trading Co., L.L.C. ["Hull Trading"], a division or subsidiary of Goldman Sachs, Inc. and a market maker in P-Tech Futures and Options, ceased to effect transactions in P-Tech Futures and Options.

67. Saul Stone and SLK are clearing members of all commodities markets under the supervision of NYCC and NYBOT.

68. Upon information and belief, Thomas, who was also a member of the P-Tech Futures and Options Settlement Committee was employed by Timber Hill Corp., a company that traded in P-Tech Futures and Options as a major counter party.

69. Upon information and belief, Timber Hill Corp. acquired such information regarding the incorrectness of the P-Tech Settlement Prices as a result of the participation of Thomas on the P-Tech Settlement Committee.

70. Upon information and belief, Hull Trading acquired such information regarding the incorrectness of the P-Tech Settlement Prices as a result of the participation of Meek on the P-Tech Settlement Committee.

71. Upon information and belief, Saul Stone acquired such information regarding the incorrectness of the P-Tech Settlement Prices as a result of the participation of Soman on the NYFE Board.

72. Not one of the NYBOT, the NYCC, the Cotton Exchange, or the NYFE nor any of the individual defendants, including, but not limited to the members of the P-Tech Settlement Committee, placed members of the industry or the public on notice of the miscalculation of the P-Tech Settlement Price or of complaints regarding the P-Tech Settlement Price.

73. Upon information and belief, not one of the NYBOT, the NYCC, the Cotton Exchange, the NYFE, or any of the individual defendants conducted any investigation, inquiry or other examination of the facts underlying any complaint regarding the P-Tech Settlement Prices of which they, or any of them, became aware.

74. At all times relevant hereto, pursuant to Section 5.4 of the NYCC rules, clearing members were required to deposit Ten (10%) of their adjusted net capital or an amount determined by a market activity formula, into the Guaranty Fund of the NYCC.

75. Effective March 31, 2000, this rule was amended to require that the guaranty requirement be the greater of 10% of the member's adjusted net capital or a new risk-based arithmetical calculation.

76. In late April, 2000, despite the amended rule, Defendant Haase, individually and on behalf of NYCC and NYBOT, informed Klein & Co. that Klein & Co. could deposit Twenty (20%) per cent of Klein & Co.'s adjusted net capital stating that "it would be too much of a hardship for Klein & Co."

77. Haase knew, or had reason to know, that in order to meet the amended Guaranty Fund requirements, Klein & Co. would have to force Eisler to liquidate his position in P-Tech Futures and Options.

78. There was no legal authority for Haase to create a 20% of adjusted net capital requirement just for Klein & Co.

79. Upon information and belief, Haase and NYCC exempted Klein & Co. from the Guaranty Fund requirements in order to benefit Eisler, to assure Eisler's continued participation in the market through Klein, and based upon his knowledge that the P-Tech Settlement Committee was manipulating the P-Tech Settlement Price.

80. On Thursday, May 11, 2000, the margin call in First West's account was computed to be Seven Hundred Thousand ($700,000.00) Dollars based upon the miscalculated price published by the Industry Defendants.

81. Klein & Co. contacted Eisler in the morning of May 11, 2000 with respect to First West's margin requirement and told him to liquidate his position and/or deposit funds to First West's account. Eisler responded that he did not know if he had enough funds to cover the margin.

82. Immediately thereafter, Klein & Co. instructed Eisler to liquidate the P-Tech Futures and Options position in the First West account, and Eisler consented.

83. Eisler then liquidated approximately 130 lots of P-Tech Futures and Options, but purchased 250 additional lots of P-Tech Futures and Options, as "liquidation for straddle," a term used within the industry to denote a position which will hedge the risk of the position. In this way Eisler was attempting to hedge the differences in strike prices to minimize his risk of loss.

84. On May 12, 2000, Eisler, while present in the offices of Klein & Co., stated to Klein & Co. that he did not have the funds to cover the margin. Eisler further advised Klein & Co. that the market was illiquid and that he would not be able to liquidate the P-Tech Futures and Options prior to the opening of the market.

85. On Friday, May 12, 2000, prior to the opening of the market, without knowledge that the settlement price was incorrect, Klein & Co. contacted O'Neill and expressed its concern regarding the illiquidity of P-Tech Futures and Options, Eisler's inability to meet First West's margin call, Eisler's stated inability to liquidate First West's contracts.

86. The market for P-Tech Futures and Options was illiquid at this time, in large part due to the fact that several other companies with prior large positions, including, but not limited to, Hull Trading. Saul Stone and SLK, had previously liquidated most or all of their P-Tech Futures and Options positions and had refused to re-enter or participate in the market.

87. Upon information and belief, Timber Hill Corp. was the only other major participant in the P-Tech

Futures and Options market and it held a position in most part directly contrary to that maintained by First West. Upon information and belief, the major part of the losses of First West corresponded to gains of Timber Hill Corp.

88. Upon information and belief, the illiquidity of P-Tech Futures and Options was caused by the knowledge possessed by P-Tech Settlement Committee members of the incorrectness of the P-Tech Settlement Price.

89. On the morning of May 12, 2000, Klein & Co. further expressed to O'Neill that there was almost a certainty that the margin deficit in First West's account, if not covered by Eisler, would exceed the assets of Klein & Co. and would ruin Eisler.

90. Klein & Co. then requested that emergency action be taken by the Board, including, but not limited to, issuance of a directive halting trading of P-Tech Futures and Options prior to the opening and liquidating all contract [sic] at the previous day's settlement price.

91. At the time that this request was made by Klein & Co. to O'Neill, the P-Tech Futures and Options market had collapsed and was entirely illiquid.

92. From the opening of business on May 15, 2000 to the close of the market that same day, the Board of NYFE never met to review the conditions of the market.

93. O'Neill stated that he saw no need for emergency action since Klein had met its margin and declined to take any action whatsoever responsive to the situation.

94. Rather than take emergency action, O'Neill contacted Hull Trading, a non-clearing member of NYBOT,

to determined [sic] if Hull Trading might take over First West's position.

95. On Friday, May 12, 2000, despite Klein's request and in spite of the pending circumstances, no one at NYBOT or NYCC requested that the NYFE Board convene to review the circumstances.

96. Upon information and belief, Eisler did not settle or participate in the settlement of the P-Tech Futures and Options settlement price on and after Monday, May 15, 2000.

97. Upon information and belief, the P-Tech Settlement Prices were incorrect up through and including May 12, 2000.

98. Margin is computed at the close of a business day using the settlement price [sic] is due and is payable the next business day. Computation of the correct P-Tech Settlement Price on Monday, May 15, 2000 became due by First West on Tuesday, May 16, 2000.

99. Upon information and belief, on May 15, 2000, Eisler's membership and membership privileges at NYBOT were suspended.

100. Upon information and belief, on Monday, May 15, 2000, the settlement price was correctly calculated by the Settlement Committee and, upon such settlement by the Committee without Eisler, the P-Tech Futures and Options Settlement Price for said dates was grossly divergent from the previous settlement prices computed by or under the supervision of Eisler. The divergence in the P-Tech Settlement Price from May 15, 2000 forward was far more detrimental to First West than were the

miscalculated prices from the period prior to May 15, 2000.

101. As a result of the correct recalculation of the settlement price of P-Tech, First West's account debit was calculated to be to Four Million Five Hundred Thousand ($4,500,000.00) dollars as of the close of business Monday, May 15, 2000, the same day that Eisler's membership was suspended.

102. At the opening of business on Tuesday, May 16, 2000, with such a large margin deficit, and no apparent funding available to cover the margin deficit from First West or Eisler, Klein & Co. was required to take an immediate charge against its net capital for the amount of First West's margin call deficiency.

103. At the opening of business on May 15, 2000, Klein & Co.'s adjusted net capital was approximately Two Million Six Hundred Fifty Thousand ($2,650,000.00) Dollars.

104. Using Two Million Six Hundred Fifty Thousand ($2,650,000.00) Dollars as a basis, the effect of the capital charge for First West's account decreased Klein & Co.'s net capital below the minimum requirement of Two Million ($2,000,000.00) Dollars.

105. Because the net capital was below Two Million ($2,000,000.00) Dollars, Klein & Co. was then non-compliant with the minimum capital required $2,000,000.00 of a clearing member of NYMEX and NYCC.

106. Member Futures Commission Merchants are obligated by the rules of the NYBOT, NYCC, NYFE and Cotton Exchange to have certain minimum capital funds.

107. Because Klein & Co.'s net capital fell below Two Million ($2,000,000.00) dollars, the NYBOT and the NYBOT Board, the NYFE, the NYFE Board and the Executives Committees of the Coffee, Sugar & Cocoa Exchange and the Cotton Exchange suspended the membership privileges of Klein & Co. for failure to meet the minimum financial requirements at the close of business on May 15, 2000.

108. As is the custom and the rule in the securities industry, clients of brokerage houses often maintain their assets with their brokerage house or FCM.

109. Funds of customers of any brokerage house or FCM maintained by the brokerage house or FCM are not counted, included, treated, designated or situated as funds of the brokerage house or FCM and remain the funds of the customers [hereinafter "Customer Funds"].

110. NYBOT and the NYCC thereafter wrongfully confiscated a sum of money and assets in the amount of approximately Eight Million ($8,000,000.00) Dollars in Customer Funds belonging to customers of Klein & Co. that were held in Klein & Co.'s segregated account at Chase Manhattan Bank.

111. On May 15, and 16, 2000, meetings were held in which false, defamatory and disparaging remarks regarding Klein & Co. were heard to be made and incorrect information disseminated, as more particularly detailed herein.

(a) On Tuesday, May 16, 2000, at 3:00 p.m. at an emergency general membership meeting held at the NYBOT's boardroom on the 8th Floor of 4 World Trade Center, New York, NY at which

Klein & Co. was represented by David Klein, several members made false and defamatory statements regarding Klein & Co., stating:

(i) One member, unknown to Plaintiff, was heard to say "Let's hear what Klein has to say." Weis, the Chairman of the Board of NYBOT, refused to allow Klein & Co. or any of its representatives to speak by stating "who cares what Klein has to say anyway?"

(b) On May 17, 2000, the defendants issued press releases which expressly and impliedly stated falsely that Klein & Co. had seized assets of its other clients to cover losses, and which press releases were distributed to all major financial publications, posted on the Internet, made available to all entities in the financial community and to all news media throughout the world. The press release stated, in pertinent part, as follows:

(i) "Specifically, NYBOT will pay the innocent customers of Klein whose funds were utilized by Klein to meet its obligations to the [New York] Clearing Corporation."

(ii) "'I am pleased at the speed and sense of fairness with which the NYBOT Board has moved in addressing this serious issue,' stated Mark D. Fichtel, NYBOT President and CEO. 'The Board obviously has taken into account the concerns and best interests of our members, and the members of other exchanges, who cleared through Klein & Co. Futures, Inc. by deciding to "make whole" the losses they incurred this week.'"

(iii) "'In fact,' added Mr. Fichtel, 'as a Designated Self Regulatory Organization, (DSRO) NYMEX

was in a position to monitor Klein's activities. In that regard, they failed to pick up on Klein's treatment of customer funds that led to the serious incidents earlier this week.'"

(iv) The press release touted the "valiant efforts of the [NYBOT] Board to do the right thing," thereby implying that Klein & Co. had resisted efforts to "do the right thing" in returning Customer Funds to Klein & Co.'s customers.

112. These statements were false and untrue and known to be false and untrue by the publishers thereof when made.

113. These statements were directly related to Klein & Co.'s industry and business reputation and were published to the general public, with specific direction to Klein & Co.'s peers, customers and industry members.

114. On and after May 16, 2000, NYBOT and NYCC were given notice by, *inter alia,* Klein & Co. and the New York Mercantile Exchange, that their confiscation of Customer Funds held by Klein & Co. was wrongful.

115. NYBOT and NYCC, in bad faith, refused to relinquish their dominion and control of Customer Funds formerly held by Klein & Co. until litigation to release said funds was commenced against them by the New York Mercantile Exchange.

116. As a direct result of the actions of the defendants, on May 16, 2000, Klein & Co. ceased to operate as a FCM, closed its offices, terminated its employees and commenced to wind up its business, which ceased to operate as of the close of business May 15, 2000.

## COUNT I

## AGAINST NYFE FOR VIOLATIONS OF RESPONSIBILITIES OF A CONTRACT MARKET

117. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 116 of the complaint with the same force and effect as though more fully set forth herein.

118. The § 5b of the Commodities Exchange Act states, in pertinent part:

> The failure or refusal of any board of trade to comply with any of the provisions of this Act, or any of the rules, regulations, or orders of then [sic] Commission thereunder, shall be cause for suspending for a period not to exceed six months or revoking the designation of such board of trade as a 'contract market'. . . .

119. NYFE, under 7 U.S.C. § 7(4) has a responsibility to maintain a stable and objective contract market. The Board and Settlement Committee failed to exercise regulatory responsibility in that, *inter alia,* in bad faith, they, and each of them, failed to supervise, failed to detect the errors in the P-Tech Settlement Price and violations of various rules and regulations, and then deliberately failed in their duty to remedy the situation in a responsible fashion.

120. NYFE failed to meet this responsibility by allowing incorrect and dishonest prices regarding P-Tech Futures and Options to be disseminated by Eisler and the P-Tech Futures and Options Settlement Committee.

121. The incorrect settlement prices caused the margin computation to skew, thereby creating a perception of lower margin risk to FCMs and potential financial disaster to FCMs, who could not anticipate or prepare for the drastic change in P-Tech Settlement Price of the P-Tech Futures and Options when the error was corrected.

122. Knowledge by various Industry Defendants of the incorrectness of the P-Tech Futures and Options Settlement Price, acquired in their capacity as members of NYBOT Board and P-Tech Futures and Options Settlement Committee, prompted said members' employers or affiliated companies to withdraw from the P-Tech Futures and Options market, resulting in the further illiquidity of the P-Tech Futures and Options market.

123. Despite the knowledge by various Industry Defendants of the incorrectness of the P-Tech Futures and Options Settlement Price, acquired in their capacity as members of NYBOT Board and P-Tech Futures and Options Settlement Committee, and of Eisler's actions and complaints relating thereto, the defendants took no action to rectify this situation, despite the fact that it destroyed the P-Tech Futures and Options market and Klein & Co.

124. In addition to, and not in lieu of the foregoing, the acts and omissions of the defendants consisted of a complete failure of market surveillance, failure in bad faith to take required action, a complete failure to maintain an orderly market, and bad faith attempts to support a collapsed, illiquid, contrived marketplace.

125. Klein & Co. contends that, based upon its foregoing actions and omissions with respect to P-Tech Futures and Options, the NYFE should not be allowed to continue to maintain and supervise any contract market

nor be designated as a contract market for the trading of any futures contracts or options thereon.

126. Upon information and belief industry Defendants contend that the NYFE should not be allowed to continue to maintain and supervise such contract markets as it has heretofore maintained and supervised.

127. In contravention of §5(7) of the CEA, the actions of the NYFE have been contrary to the public interest.

128. The Industry Defendants are required to provide for the prevention of manipulation and the cornering of any commodity by dealers and operators.

129. The Industry Defendants were obligated to exercise reasonable diligence in observing and making themselves aware of market conditions in order to carry out their regulatory responsibilities.

130. Because of the Industry Defendants' relation to the public, they are bound to act with the utmost objectivity, impartiality, honesty and good faith, despite their obligation to act where their own private interests are concerned.

131. The defendants failed or refused to conduct themselves in accordance with the foregoing duties of honesty and good faith. The defendants' dominant and decisive motivation and intent was to advance the defendants' individual and/or corporate self-interest and/or to derive direct personal gain, rather than to advance the public interest, all of which was in bad faith.

132. The actions of the Industry Defendants have been motivated by bad faith and ulterior motives, as is indicated by the following actions and inaction:

(a) The Industry Defendants did not supervise the trading of Eisler, particularly with respect to P-Tech Contract and Options over which he had supervisory authority.

(b) Eisler manipulated the P-Tech Settlement Price for his own benefit and gain and the other Industry Defendants encouraged, tolerated and concealed his activities.

(c) The defendants took no action with respect to complaints received during March, April and May, 2000, with respect to Eisler's activities.

(d) The defendants took no action with respect to complaints received on the trading of P-Tech Futures and Options.

(e) The Industry Defendants acted in self-interest, rather than in the interest of a liquid, fair market and in the public interest, by either withdrawing from the contract market or ignoring the lack of viability and liquidity of the market, rather than reporting, investigating and/or remedying same.

(f) The Industry Defendants acted to protect Eisler by excusing certain financial requirements of Klein & Co. so that he would not have his trading curtailed.

(g) The Industry Defendants ignored warnings from Klein & Co. and other market participants prior to the suspension of Eisler.

(h) The Industry Defendants indicated in meetings that they had no interest in granting any hearing of Klein & Co.'s allegations regarding Eisler's market manipulation with the complicity of the other defendants.

(i) The Industry Defendants have arbitrarily and capriciously labeled Klein & Co. the wrongdoer in order to deflect attention from their own wrongdoing with respect to this matter, including, but not limited to casting aspersions regarding the integrity and competence of the New York Mercantile Exchange, which committed no wrongdoing with respect to the events and, after May 15, 2000, only sought to restore to Klein & Co.'s customers the Customer Funds converted by the NYBOT and NYCC.

(j) The Industry Defendants took no action to prevent Eisler from establishing incorrect settlement prices for P-Tech Futures and Options while he (through his company First West) was a major participant in the market.

(k) The Industry Defendants facilitated and encouraged Eisler, individually and in his capacity, *inter alia,* as a member of the P-Tech Settlement Committee and as the Chairman of the Board of NYFE, to dominate the contract market for P-Tech Futures and Options to the detriment of the public and the contract market and for his own profit and gain.

(l) The Industry Defendants refused to elicit from the president of Klein & Co. a description of the events, slandered him as a liar before Klein & Co.'s peers in the industry, and then libeled Klein & Co. in press releases issued to the industry, news media and public and published on the Internet.

(m) At the meeting of May 15, 2000, Thomas Pedafee, the President of Timber Hill Corp., stated over speakerphone to all present that Timber Hill Corp. did not know how the P-Tech

Settlement Committee had generated the P-Tech Settlement Prices and that Timber Hill Corp. considered them unreliable for a period of time (unknown to plaintiff) prior to May 15, 2000.

(n) The Industry Defendants falsely accused Klein & Co. of misappropriating its Customer Funds.

133. The foregoing acts were inconsistent with, contrary to and inviolation [sic] of their duties and responsibilities to advance the public interest and to act with the utmost objectivity, impartiality, honesty and good faith.

134. Klein & Co. has no adequate remedy at law.

135. There presently exists a justiciable controversy which requires an adjudication by a court of competent jurisdiction.

136. Absent an adjudication and the issuance of a declaratory judgment, Klein & Co. and the public at large will suffer irreparable injury.

## COUNT II

## AGAINST ALL DEFENDANTS FOR VIOLATION *INTER ALIA*, OF § 4b OF THE CEA AND 17 CFR § 33.9

137. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 136 of the complaint with the same force and effect as though more fully set forth herein.

138. § 4b of the CEA, entitled "Fraudulent Transactions Prohibited" states, in pertinent part, as follows:

(a) It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent,

> or employee of any member . . . or (2) for any person . . . (B) determining the price basis of any transaction in interstate commerce in such commodity, or (C) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof –
>
> (i) to cheat or defraud or attempt to cheat or defraud such other person;
>
> (ii) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;
>
> (iii) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract. . . .

139. 17 C.F.R. § 33.9 states, in pertinent part, as follows:

> It shall be unlawful for any person –
>
> * * *
>
> (d) To manipulate or attempt to manipulate the market price of any commodity option on or subject to the rules of any contract market. . . .

140. 17 C.F.R. § 33.10 states, in pertinent part, as follows:

> It shall be unlawful for any person directly or indirectly –
>
> (a) To cheat or defraud or attempt to cheat or defraud any other person;
>
> (b) To make or cause to be made to any other person any false report or statement thereof or cause to

be entered for any person any false record thereof;

(c) To deceive or attempt to deceive any other person by any means whatsoever

in or in connection with an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction.

141. Rule 9.01 of the By-Laws and Rules of the Cotton Exchange, states, in pertinent part, as follows:

No person under the jurisdiction of the New York Cotton Exchange (NYCE®) or its affiliates; including the Citrus Associations of the New York Cotton Exchange, Inc. (CITRUS) and the New York Futures Exchange, Inc. (NYFE), (collectively the Exchange):

(a) Shall engage in any misconduct in his relations to the Exchange or to any member of the Exchange;

(b) Shall engage in any dishonest or fraudulent transaction relating to contracts on the Exchange;

(c) Shall engage in any conduct detrimental to the best interests of the Exchange;

(d) Shall engage in any conduct inconsistent with just and equitable principles of trade.

142. First West, through Eisler, violated these provisions as it willfully caused and enabled these P-Tech Futures and Options to be traded in his proprietary account through First West at Klein & Co. knowing that the P-Tech Settlement Prices were being artificially manipulated.

143. First West willfully deceived Klein & Co. because its owner, Eisler, knew that the P-Tech Settlement Prices and therefore the margin amount required by Klein & Co. was incorrect.

144. Eisler willfully as, *inter alia,* a member of the contract market, Chairman of NYFE and member of the P-Tech Settlement Committee, which determines the Settlement Price of P-Tech Futures and Options and otherwise regulates trading thereof in issue, defrauded Plaintiff by incorrectly, either willfully acting in bad faith or through gross negligence, causing the P-Tech Settlement Price to be improperly calculated for at least two months.

145. The miscalculation of the P-Tech Settlement Price created substantial financial benefit to Eisler, a complete disruption of a fair market for P-Tech Futures and Options, no benefit to Klein & Co. and an undisclosed risk of financial ruin or windfall at the expense of other innocent parties for various other entities.

146. Eisler in bad faith caused false reports regarding the P-Tech Settlement Price to be generated and published.

147. The NYBOT and its Board, as members, agents and employees of members who determine the base price of transactions in interstate commerce, in bad faith, whether willfully or through gross negligence, caused false reports and statements to be generated regarding the P-Tech Settlement Price.

148. NYCC and its Board members, as members, agents and employees of members who determine the base price of transactions in interstate commerce, caused, in

bad faith, whether willfully or through gross negligence, false reports and statements to be generated regarding the P-Tech Settlement Price.

149. Cotton Exchange and its agents, employees, and members who determine the base price of transactions in interstate commerce, caused, whether willfully or through gross negligence, false reports and statements to be generated regarding the P-Tech Settlement Price.

150. NYFE and its Board and the P-Tech Futures and Options Settlement Committee as members, agents and employees of members who determine the base price of transactions in interstate commerce, caused, in bad faith, whether willfully or through gross negligence, false reports and statements to be generated regarding the P-Tech Settlement Price.

151. Upon information and belief, NYFE's market surveillance department, and other divisions of NYFE, including, but not limited to NYFE's control committee, had notice of said market manipulation through, *inter alia,* its receipt and/or review of daily reports.

152. NYFE, its officers, directors, employees and its divisions and departments, deliberately and in bad faith failed to advise Plaintiff and failed to take action even when other customers and clearing members withdrew from the market for P-Tech Futures and Options.

153. This false information regarding the P-Tech Settlement Price disseminated by the Industry Defendants was used to calculate margin, and, in turn, the adjusted capital requirements of Klein & Co.

154. The false settlement price caused either the appearance of a lower margin requirement or the lack of a

margin deficiency on the part of First West, and the appearance of greater adjusted capital for Klein & Co.

155. The actions of the defendants were in violation of, *inter alia,* the laws, rules and regulations cited above.

156. Due to the acts of Eisler, the NYBOT and its Board members, NYCC and its board members, Cotton Exchange, and its Board, the NYFE and its board members, the P-Tech Futures and Options Settlement Committee, the officers, directors and employees of the foregoing, Klein & Co. fell below the minimum capital requirements and was suspended, thereby terminating its ability to do business. The result of this was, *inter alia,* Klein & Co. was forced, after forty years, out of business, Klein & Co.'s name and goodwill was sullied in the newspapers and throughout the financial world, and Klein & Co.'s ability to ever re-enter the commodities industry in any capacity whatsoever was destroyed.

157. As a direct result of the actions and omissions of the defendants, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

158. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

159. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT III

## AGAINST ALL DEFENDANTS FOR VIOLATION OF OF [sic] § 9 OF THE CEA'S INSIDER TRADING PROSCRIPTION

160. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 160 of the complaint with the same force and effect as though more fully set forth herein.

161. §9(f)(1) of the CEA states, in pertinent part, as follows:

It shall be a felony for any person –

> (1) who is an employee, member of the governing board, or member of any committee of a board of trade, contract market, or registered futures association, in violation of a regulation issued by the Commission, willfully and knowingly to trade for such person's own account, or for or on behalf of any other account. . . .

162. First West willfully violated this provision because one of its principals, Eisler, as a member of the contract market and as the Chairman of the Board of NYFE, who determines the P-Tech Settlement Price, traded P-Tech Futures and Options for his own benefit through First West.

163. The Industry Defendants violated their duty to enforce the rules and regulations of the CEA and failed in that supervisory duty by allowing Eisler to manipulate the P-Tech Settlement Price, a necessary element in Eisler's manipulative scheme.

164. NYCC and its members of the governing board and/or members of committees of a board of trade violated their duty to enforce the rules and regulations of the CEA and failed in their supervisory, regulatory and investigatory duty respecting the manipulation of the P-Tech Settlement Price.

165. Cotton Exchange and its members of the governing board and/or members of committees of a board of trade violated their duty to enforce the rules and regulations of the CEA and failed in that supervisory duty.

166. NYFE, its Board and Control Committee, and the P-Tech Contract and Options Settlement Committee violated this section because they have a duty to enforce the rules and regulations of the CEA and failed in that supervisory, regulatory and enforcement duty.

167. As a direct result of the actions and omissions of defendants, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

168. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

169. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT IV

## AGAINST ALL DEFENDANTS FOR BREACH OF FIDUCIARY DUTY

170. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 169 of the complaint with the same force and effect as though more fully set forth herein.

171. Eisler had a fiduciary duty to honestly and fairly discharge his duties and responsibilities of Chairman of NYFE and member of the Settlement Committee in accordance with all the rules and regulations of the various governing boards.

172. Eisler breached that duty by using his position on the Settlement Committee, whether willfully of [sic] through gross negligence and reckless disregard of his duties in bad faith, to incorrectly set the P-Tech Settlement Price for his own benefit and interest, thereby causing the original margin calculation of P-Tech Futures and Options to be incorrect.

173. The acts of Eisler directly caused Klein & Co. to incorrectly calculate the price and margin amount cleared through the NYCC for First West's account.

174. Said miscalculation by Klein & Co. resulted in a lower margin requirement in First West's account.

175. O'Neill had a fiduciary duty to perform his job as Executive Vice-President/President-Financial Products, which placed O'Neill in charge of all financial products of NYFE in accordance with all applicable rules and regulations of the CEA and CFR and with the due

diligence, honesty and principles of an officer of NYFE and NYBOT.

176. O'Neill breached said duty and exercised bad faith when he, *inter alia,* failed to contact any Board member of the NYFE to take emergency action to stop the collapse of the market at the expense of Plaintiff and take other action to investigate, remedy or ameliorate the situation.

177. O'Neill breached said duty and exercised bad faith when his sole activity (upon being advised by Klein & Co. of the conditions of the market) was to contact Hull Trading in order to solicit and ascertain whether Hull Trading would consider taking over First West's portion in the market. Such actions were exercised in bad faith since O'Neill knew that the only way Hull Trading could take over First West's position in the market was through emergency action of the Board since Hull Trading was not a clearing member of NYFE.

178. O'Neill breached said duty and exercised bad faith when he failed to take action warranted by the circumstances, including, but not limited to, the closing of the market on May 12, 2000.

179. NYBOT and its board members, committees, divisions, departments, officers, and its employees, had a duty and responsibility, *inter alia,* to enforce the various rules and regulations which governed Eisler, the P-Tech Settlement Committee, P-Tech Futures and Options and to maintain an orderly and efficient market.

180. NYBOT and its board members breached that duty by, *inter alia*, failing to properly supervise its Board, Board members and related entities and their actions,

neglecting complaints, and by violating its responsibilities to maintain a [sic] objective, fair and orderly contract market for P-Tech Futures and Options.

181. NYCC and its officers and board members had a duty and responsibility, *inter alia,* to enforce the various rules and regulations which governed Eisler, the P-Tech Settlement Committee, P-Tech Futures and Options and to maintain an orderly and efficient market.

182. NYCC and its officers and board members breached that duty by failing to properly utilize the Guaranty Fund rather than seizing the Customer Funds.

183. Cotton Exchange and its Board had a duty and responsibility, *inter alia*, to enforce the various rules and regulations which governed Eisler, the P-Tech Settlement Committee, P-Tech Futures and Options and to maintain an orderly and efficient market.

184. Cotton Exchange and its board members breached that duty by knowingly ignoring or failing to discover the actions of Eisler in setting an incorrect P-Tech Futures and Options Settlement Price, by failing to act on or publicize complaints regarding the P-Tech Futures and Options Settlement Price, by acting on said information for their own benefit prior to acting on behalf of the persons to whom they owed a duty, and by acting in concert with Eisler in setting an incorrect P-Tech Settlement Price.

185. NYFE and its board members had a duty and responsibility, *inter alia,* to enforce the various rules and regulations which governed Eisler, the P-Tech Settlement Committee, P-Tech Futures and Options and to maintain an orderly and efficient market.

186. NYFE and its board members breached that duty by failing to discover the actions of Eisler in setting an incorrect P-Tech Futures and Options Settlement Price, by failing to act on or publicize complaints regarding the P-Tech Futures and Options Settlement Price, by acting on said information for their own benefit prior to acting on behalf of the persons to whom they owed a duty, and by acting in concert with Eisler in setting an incorrect P-Tech Settlement Price.

187. The NYFE Control Committee and P-Tech Settlement Committee had a duty and responsibility, *inter alia,* to enforce the various rules and regulations which governed the P-Tech Settlement Committee, P-Tech Futures and Options and to maintain an orderly and efficient market. In addition to, and not in lieu of the foregoing, the members of the P-Tech Settlement Committee were obligated to discharge their duties with due diligence, to refrain from acting in self-interest.

188. The P-Tech Settlement Committee breached that duty by, *inter alia,* knowingly ignoring or failing to discover the actions of Eisler in setting an incorrect P-Tech Futures and Options Settlement Price, by failing to act on or publicize complaints regarding the P-Tech Futures and Options Settlement Price, by acting on said information for their own benefit prior to acting on behalf of the persons to whom they owed a duty, and by acting in concert with Eisler in setting an incorrect P-Tech Settlement Price.

189. All of the duties owed by the foregoing entities were owed, *inter alia,* to Klein & Co.

190. Based upon the foregoing breaches of their fiduciary duties, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

191. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

192. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT V

## AGAINST ALL DEFENDANTS FOR GROSS NEGLIGENCE AND BAD FAITH

193. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 192 of the complaint with the same force and effect as though more fully set forth herein.

194. Defendants owed to Klein & Co. the duties hereinabove set forth.

195. Defendants breached that duty by failing to exercise even the minimum standards of care required by persons or entities in their position with respect to monitoring, supervising, maintaining and protecting an objective and fair market and by placing Klein & Co. at risk and by taking no action to prevent or ameliorate said situation.

196. The actions of defendants constituted gross negligence in that they were effected with such a gross want of care and regard for the rights of its members and the public at large, as to justify the presumption of

willfulness and wantonness and/or in that they intentionally failed to perform manifest duties in reckless disregard of the consequences as affecting the property of others.

197. The actions of defendants were effected in bad faith in that they were effected solely for the benefit of the defendants themselves and their fellow defendants and to the detriment of Klein & Co., as evidenced, *inter alia,* by the verbal statements made against Klein & Co., by the press releases issued with respect to Klein & Co. in May, 2000, by forewarning of at least one customer of Klein & Co. causing said client to close said client's account, by the failure to take action on complaints received with respect to the P-Tech Futures and Options Settlement Price, and by the failure to take action to prevent or ameliorate the situation.

198. As a direct result of the gross negligence and bad faith of defendants, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

199. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

200. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT VI

## AGAINST NYCC AND NYBOT CORPORATION FOR CONVERSION

201. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 200 of the complaint with the same force and effect as though more fully set forth herein.

202. Klein & Co., through its contractual relations with its clients, had the right to maintain custody and control over its clients' funds. At all times herein, Klein & Co. had control and dominion of said funds.

203. Klein & Co., through its contractual relations with its clients had the right to maintain custody and control over accounts receivables owed to it by its clients.

204. NYCC and NYBOT forgave or otherwise compromised said accounts receivable by, *inter alia,* adjusting the Customer Funds to credit the amounts of the accounts receivable owed by said customers to Klein & Co.

205. Klein & Co. promised, expressly and impliedly in accepting the accounts of its public customers. [sic] to safeguard and hold their individual funds for their benefit.

206. Klein & Co., had in its possession prior to May 15, 2000 approximately $14,000,000.00 in funds belonging to its clients which it was holding pursuant to its contractual relations with its clients.

207. On or about May 15, 2000, NYCC and NYBOT wrongfully confiscated said funds from Klein & Co. and placed said funds under the NYBOT's dominion and control.

208. NYCC and NYBOT have exercised dominion and control over the funds of Klein & Co.'s clients intentionally and with the full knowledge that such conduct was wrongful.

209. NYBOT only relinquished its dominion and control over the funds of Klein & Co.'s clients after a lawsuit was commenced in this Court by the New York Mercantile Exchange.

210. As a direct result of the conversion committed by the NYCC and the NYBOT, Klein & Co. has suffered damages in excess of $10,000,000.00 in an amount to be determined at trial.

211. The actions of said defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

212. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $30,000,000.00.

## COUNT VII

## AGAINST ALL DEFENDANTS FOR COMMON-LAW FRAUD

213. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 212 of the complaint with the same force and effect as though more fully set forth herein.

214. Defendants made representations of facts or omitted to state facts in bad faith which would have been deemed material by a person in the position of Klein & Co.

215. Such representations were false and known to be false when made.

216. The defendants who omitted to act or make any disclosure to Klein & Co. and/or the public were aware that their actions and/or disclosure would have protected Klein & Co. from any loss.

217. Defendants' actions and omissions were intentionally effected in bad faith.

218. As a direct result of the defendants' actions, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

219. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

220. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT VIII

## AGAINST ALL INDUSTRY DEFENDANTS FOR DEFAMATION

221. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through

220 of the complaint with the same force and effect as though more fully set forth herein.

222. The statements hereinabove set forth by the Industry Defendants were false and known to be false when made.

223. The statements concerned Klein & Co.'s business and reputation in the industry.

224. The statements were intentionally published by the Industry Defendants and intentionally directed at the public, Klein & Co.'s peers and customers, the news media and the public.

225. The defamatory statements published by the defendants were false and known to be false when made.

226. Defendants' publication of the defamatory statements was intentionally and knowingly made.

227. As a direct result of the defamatory actions of defendants, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

228. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

229. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT IX

## AGAINST ALL DEFENDANTS FOR INTENTIONAL INTERFERENCE WITH CONTRACTUAL RELATIONS

230. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 229 of the complaint with the same force and effect as though more fully set forth herein.

231. Klein & Co. promised, expressly through its client agreements and impliedly in accepting the accounts of its public customers, to safeguard and hold their individual funds for their benefit.

232. Defendants have knowledge of the contractually and fiduciary obligations of Klein & Co. to any and all clients.

233. By intentionally and wrongfully confiscating the funds of Klein & Co.'s customers, defendants interfered with the contractual rights of Klein & Co.

234. As a direct result of the actions of defendants, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

235. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

236. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT X

## AGAINST ALL DEFENDANTS FOR PRIMA FACIE TORT

237. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 236 of the complaint with the same force and effect as though more fully set forth herein.

238. The foregoing actions were committed intentionally and solely with the intent to cause economic harm to Klein & Co.

239. As a direct result of the actions of defendants, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

240. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

241. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

## COUNT XI

## AGAINST COTTON EXCHANGE, NYFE, NYBOT AND NYCC FOR RESPONDEAT SUPERIOR

242. Plaintiff repeats and reiterates each and every allegation contained in paragraphs numbered 1 through 239 [sic] of the complaint with the same force and effect as though more fully set forth herein.

243. In the event that any or all of the individual defendants is found liable, then liability must be imposed on Cotton Exchange, NYFE, NYBOT and NYCC.

244. As a direct result of the actions of defendants, Klein & Co. has suffered damages in excess of $25,000,000.00 in an amount to be determined at trial.

245. The actions of the defendants were effected intentionally, maliciously and solely with the intent to cause damage to Klein & Co., or with such wanton disregard for the safety of the public and third-parties, as to warrant the award of punitive damages.

246. Based upon the actions of defendants, plaintiff is entitled to an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00.

247. Plaintiff demands a jury trial of all issues and counts herein.

WHEREFORE, Plaintiff demands judgment against the defendants as follows:

(a) on the first count for violation of the CEA, a judgment declaring that the NYFE shall be and hereby is suspended as a contract market; and

(b) on the second count for various statutory and/or regulatory violations, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater

amount as the trier of fact deems appropriate; and

(c) on the third count for various statutory violations relating to insider trading, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(d) on the fourth count for breach of fiduciary duty, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(e) on the fifth count for gross negligence and bad faith, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(f) on the sixth count against NYBOT and NYCC for conversion, compensatory damages in excess of $10,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $30,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(g) on the seventh count for common law fraud, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(h) on the eighth count for defamation, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(i) on the ninth count for intentional interference with contractual relations, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(j) on the tenth count for prima facie tort, compensatory damages in excess of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(k) on the eleventh count for respondeat superior, compensatory damages in excess

of $25,000,000.00 in an amount to be determined at trial, and an award of punitive damages in treble the amount of compensatory damages claims, to wit, $75,000,000.00, or in such greater amount as the trier of fact deems appropriate; and

(l) for such other, further and different relief as to this Court seems just and proper; and

(m) the costs and disbursements of this action.

Dated: New York, New York
July 20, 2000

ALONSO, FERRIGNO & ANDALKAR, P.C.

By: /s/ Mark J. Alonso
Mark J. Alonso [MJA-9582]
Attorneys for Plaintiff
275 Madison Avenue
New York, NY 10016
212-972-4400

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

KLEIN & CO. FUTURES, INC.,

Plaintiff,

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., FIRST WEST TRADING, INC., NORMAN EISLER, MARK D. FICHTEL, ALBERT WEIS, JEFF SOMAN, CHARLES SWEENEY, AL PERAS, CHRIS MEEK and "JOHN DOE" 1 through 10, NEW YORK CLEARING CORPORATION, GEORGE HAASE, LAWRENCE GULITTI, BRYAN SAYLER, HITESH TRIVEDI, and "RICHARD ROE" 1 through 10, NEW YORK COTTON EXCHANGE, INC. NEW YORK FUTURES EXCHANGE, INC. JOSEPH O'NEILL, WALTER FAIR, EVAN THOMAS, JOSEPH JACH and "PETER POE" 1 through 10,

Defendants.

00 Civ. 5563 (GBD)

**NOTICE OF MOTION TO DISMISS THE COMPLAINT AS AGAINST THE NYBOT DEFENDANTS**

ORAL ARGUMENT REQUESTED

PLEASE TAKE NOTICE that, upon the annexed affidavit of Howard R. Hawkins, Jr., sworn to on October 16, 2000,

and the exhibits thereto, defendants the Board of Trade of the City of New York, Inc., New York Cotton Exchange, Inc., New York Futures Exchange, Inc., New York Clearing Corporation, Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peras, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Hitesh Trivedi, Joseph O'Neill, Walter Fair, Evan Thomas, and Joseph Jach (collectively, the "NYBOT Defendants") will move this Court, before the Honorable George B. Daniels, United States District Judge, at the United States District Court for the Southern District of New York, 500 Pearl Street, New York, New York 10007, on the 19th day of December, 2000, at 10:00 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard, for an Order:

(a) pursuant to Federal Rule of Civil Procedure 12(b)(6), dismissing Counts I through III of the complaint as against the NYBOT Defendants for failure to state a claim upon which relief can be granted;

(b) pursuant to Federal Rule of Civil Procedure 12(b)(1) and 28 U.S.C. § 1367, dismissing Counts IV through XI of the complaint as against the NYBOT Defendants for lack of subject matter jurisdiction, or in the alternative, dismissing Counts IV through XI of the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted;

(c) pursuant to Federal Rule of Civil Procedure 9(b), dismissing Counts II and VII of the complaint as against the NYBOT Defendants; and

(d) for such other and further relief, including attorneys fees and costs, as the Court deems just and proper.

PLEASE TAKE FURTHER NOTICE that, pursuant to the briefing schedule set forth in the Stipulation and Order dated September 13, 2000, all papers in opposition to this motion shall be served upon and received by the undersigned not later than December 1, 2000.

Dated: New York, New York
October 16, 2000

CADWALADER, WICKERSHAM & TAFT

By: /s/ HR Hawkins Jr.
Howard R. Hawkins, Jr.
(HH 2787)
100 Maiden Lane
New York, New York 10038
Telephone: (212) 504-6000

Attorneys for Defendants The Board of Trade of the City of New York, Inc., New York Cotton Exchange, Inc., New York Futures Exchange, Inc., New York Clearing Corporation, Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peras, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Hitesh Trivedi, Joseph O'Neill, Walter Fair, Evan Thomas, Joseph Jach

TO: Mark J. Alonso, Esq.
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Attorney for Defendants
Norman Eisler and First West Trading, Inc.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

KLEIN & CO. FUTURES, INC.,

Plaintiff,

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., FIRST WEST TRADING, INC., NORMAN EISLER, MARK D. FICHTEL, ALBERT WEIS, JEFF SOMAN, CHARLES SWEENEY, AL PERAS, CHRIS MEEK and "JOHN DOE" 1 through 10, NEW YORK CLEARING CORPORATION, GEORGE HAASE, LAWRENCE GULITTI, BRYAN SAYLER, HITESH TRIVEDI, and "RICHARD ROE" 1 through 10, NEW YORK COTTON EXCHANGE, INC., NEW YORK FUTURES EXCHANGE, INC. JOSEPH O'NEILL, WALTER FAIR, EVAN THOMAS, JOSEPH JACH and "PETER POE" 1 through 10,

Defendants.

00 Civ. 5563 (GBD)

**AFFIDAVIT OF HOWARD R. HAWKINS IN SUPPORT OF THE NYBOT DEFENDANTS' MOTION TO DISMISS THE COMPLAINT**

STATE OF NEW YORK )
ss.:
COUNTY OF NEW YORK )

HOWARD R. HAWKINS, JR., being duly sworn, says:

1. I am a Member of the Bar of this Court, and of the firm of Cadwalader, Wickersham & Taft, attorneys for defendants the Board of Trade of the City of New York, Inc. ("NYBOT"), New York Cotton Exchange, New York Futures Exchange, Inc., New York Clearing Corporation, Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peras, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Hitesh Trivedi, Joseph O'Neill, Walter Fair, Evan Thomas, and Joseph Jach (the "NYBOT Defendants"). I submit this affidavit in support of the NYBOT Defendants' motion to dismiss the Complaint of plaintiff Klein & Co. Futures, Inc. ("Klein & Co.") pursuant to Federal Rules of Civil Procedure 12(b)(1), 12(b)(6), and 9(b).

2. Annexed hereto as Exhibit A is a true copy of plaintiffs Complaint, dated July 20, 2000.

3. In the Complaint, plaintiff alleges that NYBOT is a board of trade. Compl. ¶ 12. NYBOT, in fact, is the ultimate parent company of the New York Cotton Exchange (the "Cotton Exchange") and its subsidiaries, New York Clearing Corporation ("NYCC") and New York Futures Exchange, Inc. ("NYFE").

4. NYFE and the Cotton Exchange are self-regulatory organizations ("SROs") designated by the U.S. Commodity Futures Trading Commission ("CFTC") as contract markets for the trading of futures and options pursuant to Sections 5 and 6(a) of the Commodity Exchange Act ("CEA"), 7 U.S.C. §§ 7, 8(a). As designated contract markets, NYFE and the Cotton Exchange are required to follow specified requirements as set forth in the CEA and CFTC Rules and Regulations promulgated thereunder,

including among other things, requirements relating to minimum financial standards and reporting requirements for futures commission merchants that are exchange members (such as plaintiff Klein & Co.), as well as requirements for customer claim procedures, and member disciplinary procedures and fitness requirements.

5. Annexed as Exhibit B is a copy of NYCC By-Law 5.5, which governs monetary defaults by Clearing Members such as Klein & Co., referenced in ¶ 106 of the Complaint.

6. Annexed as Exhibit C is a copy of amended NYCC By-Law 5.4, governing Guaranty Fund deposits for Clearing Members, referenced in ¶¶ 74-76 of the Complaint.

7. In its Complaint, plaintiff Klein & Co. does not allege that it traded for its own account in the Pacific Stock Exchange Technology Index Futures Contracts and Options ("P-Tech Futures and Options"). I am informed by knowledgeable representatives of NYCC that exchange records indicate that during 2000, Klein & Co. never traded P-Tech Futures or Options for its own account.

8. Annexed as Exhibit D is a copy of the May 17, 2000 Press Release issued by NYBOT, referenced in ¶ 111 of the Complaint.

9. Annexed as Exhibit E are copies of NYFE Rule 137, NYCC By-Law 6.5, and Cotton Exchange Rule 5.09 (and as amended, Rule 6.37), each of which provide that any member (such as plaintiff Klein & Co.) that fails to prevail in any action against NYFE, NYCC, the Cotton Exchange, or any of their officers, directors or committee members, shall be liable to pay all reasonable attorneys fees and costs of the defense of such proceeding.

10. For the reasons set forth in the NYBOT Defendants' accompanying Memorandum of Law, the Complaint as against the NYBOT Defendants should be dismissed in all respects, with costs and attorneys fees.

/s/ H. R. Hawkins, Jr.
HOWARD R. HAWKINS, JR.

Sworn to before me this
16th day of October 2000.

/s/ Christine P. Jackson
Notary Public

CHRISTINE P. JACKSON
Notary Public, State of New York
No. 02JA5088035
Qualified in Kings County
Certificate Filed in New York County
Commission Expires Nov. 10, 2001

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**EXHIBIT B**

NYCC By-Law

Section 5.5. Monetary Defaults: Use of Guaranty Fund: Assessments

If any Clearing Member fails to deposit with, or pay to, the Corporation in full any original margin, variation margin, option premium or other sum (not including any dues, assessments or fines) under or in connection with any Contract or fails to satisfy any reimbursement obligation to the Corporation in full under or in connection with any Cross Margining Program, when and as required by or pursuant to the rules of the Listing Exchange, the Rules of the Corporation or pursuant to the terms of any Cross Margin Program, such failure shall constitute a "Monetary Default." If and at such time as the Corporation

has in effect a procedure whereby deposits or payments of sums with or to the Corporation are effected by having the Corporation instruct the Clearing Members' banks to wire transfer funds from their accounts with such banks directly to the accounts of the Clearing Corporation, a Clearing Member shall be deemed to have failed to deposit or pay any sum when and as required if such Clearing Member's bank fails so to wire transfer funds when and as instructed by the Corporation. In the event that at any time a Monetary Default occurs on the part of any Clearing Member (the "Defaulting Clearing Member"), then:

(a) Such Defaulting Clearing Member's original margin on deposit with the Corporation (in both customer and proprietary accounts), its Guaranty Fund deposits and any of its other assets under the control of the Corporation shall be applied by the Corporation to pay the amount owing (the "Defaulted Obligation") as hereinafter set forth. If and to the extent a Monetary Default relates to a Contract carried in the customer account of a Defaulting Clearing Member, such margin, Guaranty Fund deposit and other assets (whether held for the proprietary account or the customer account) shall be applied to pay the Defaulted Obligation. If and to the extent a Monetary Default relates to a Contract carried in the proprietary account of a Defaulting Clearing Member, such Guaranty Fund deposit, but only that portion of such margin and such other assets as are held for the proprietary account, shall be applied to pay the Defaulted Obligation. The Defaulting Clearing Member shall immediately restore any deficiencies in its margin and Guaranty Fund deposits resulting from any such application.

(b) If the margin, Guaranty Fund deposit and other assets of a Defaulting Clearing Member under the control of the Corporation are in the aggregate less than the Defaulted Obligation, and if the Defaulting Clearing Member fails to pay the Corporation the amount of the deficiency on demand, such Defaulting Clearing Member shall continue to be liable therefor, but the amount of the deficiency, until collected from the Defaulting Clearing Member, shall be met from the following sources of funds in the order listed (each such source to be fully utilized before the next following source is applied):

(i) such portion, if any, of the surplus of the Corporation as the Board determines to be available for such purpose;

(ii) If the President, with the concurrence of the Chairman or the Vice Chairman, so determines, a loan on such terms and conditions as they may determine to be necessary or appropriate (including without limitation granting an assignment, pledge or other lien on or security interest in the Guaranty Fund or the cash, securities and other property held in the Guaranty Fund as provided in Section 5.4(f) of these By-Laws);

(iii) subject to Section 5.4(g)(ii) of these By-Laws, the Guaranty Fund;

(iv) insurance proceeds, if any, received by the Corporation in connection with the Monetary Default giving rise to the Defaulted Obligation; and

(v) assessments levied by the Corporation upon the Clearing Member (other than the Defaulting Clearing Member) as hereafter provided in this Section 5.5.

The total amount to be assessed at any one time pursuant to clause (v) of this paragraph (b) is hereinafter called the "Assessment Amount."

(c) The amount of any assessment levied on any Clearing Member shall be computed as follows:

(i) Divide the number of futures contracts, options and other contracts or instruments involving all commodities traded on or subject to the rules of any Exchange which were cleared for such Clearing Member by the Corporation and by any Former Clearing Organization for the period of six months preceding the Monetary Default by the total number of futures contracts, options and other contracts or instruments involving in such commodities cleared by the Corporation and any Former Clearing Organization during such six-month period for all Clearing Members being assessed, and multiply the resultant fraction by 20% of the Assessment amount.

(ii) Divide the total daily gross open interest in futures contracts, options and other contracts or instruments involving such commodities carried by the Corporation and any Former Clearing Organization during such six-month period for such Clearing Member by the total daily gross open interest in futures contracts, options, and other contracts or instruments carried by the Corporation and any Former Clearing Organization during such six-month period for all Clearing Members being assessed, and multiply the resultant fraction by 80% of the Assessment Amount.

(iii) For each Clearing Member, add the amounts computed pursuant to subparagraphs (i) and (ii). The total shall constitute the amount of the assessment to be levied on such Clearing Member pursuant to this paragraph (c).

(d) If the amount assessed against any Clearing Member as determined pursuant to paragraph (c) of his Section 5.5 would exceed the maximum set forth in paragraph (e) of this Section 5.5, or if the amount assessed against any Clearing Member shall exceed the amount paid by such Clearing Member, the excess shall be assessed against the other Clearing Members (other than the Defaulting Clearing Member and any Clearing Member that shall have been assessed the maximum permitted by paragraph (e)) in accordance with such subparagraph (c), as if the excess were the Assessment Amount. Assessments pursuant to this paragraph (d) shall be repeated until the entire Assessment Amount shall have been assessed.

(e) If a Person shall withdraw as a Clearing Member, and if on the Withdrawal Date no assessment shall have been imposed upon such Clearing Member within the period of ten Business Days preceding the Withdrawal Date, or if on the Withdrawal Date an assessment shall have been so imposed during such period and such assessment shall have been paid in full (subject to the Assessment Cap), then the total amount that may be assessed against such Clearing Member pursuant to this Section 5.5 on and after the first day of such period shall not exceed an amount (the "Assessment Cap") which is the lesser of:

(i) 25% of such Clearing Members Capital; or

(ii) $10 million.

Amounts deposited by Clearing Members in the Guaranty Fund, including without limitation amounts deposited to restore a deficiency as provided in Section

5.4(g)(ii) do not constitute assessments imposed or paid and are not subject to the Assessment Cap.

(f) If in any case, because of the limitations contained in paragraph (e) of this Section 5.5, the maximum permitted assessments are less than the Assessment Amount, the Board shall determine what if any further action to take, provided that under no circumstances may the Board levy assessments on any Clearing Member that would exceed the limitations contained in paragraph (e) of this Section 5.5.

(g) Notwithstanding any other provision of these By-Laws, a Person which withdraws as a Clearing Member shall be subject only to assessments imposed to meet:

(i) Monetary Defaults occurring prior to the date on which such Clearing Member's withdrawal becomes effective or such Person otherwise ceases to be a Clearing Member (the "Withdrawal Date"), subject to the limitations contained in paragraph (e) of this Section 5.5;

(ii) assessments levied under Section 5.4(j) of these By-Laws prior to the effective date of such Clearing Member's withdrawal; and

(iii) the first Monetary Default occurring after the Withdrawal Date, subject to the limitations contained in paragraph (e) of this Section 5.5.

(h) All assessments shall be due and payable within such time as the Corporation may prescribe. If any Person shall not pay any assessment when due, such Person shall continue to be liable therefor, but the Corporation may assess the Clearing Members (other than such Person, the Defaulting Clearing Member and any Clearing Member

that shall have been assessed the maximum amount permitted by paragraph (e)) for the unpaid amount in accordance with paragraphs (c) and (d) of this Section 5.5.

(i) If, after making any assessments to meet any Defaulted Obligation owing by a Defaulting Clearing Member as referred to in paragraph (b), or to meet any assessment not paid as referred to in paragraph (h), the Corporation collects the amount of such Defaulted Obligation or such unpaid assessment in whole or in part from the Person or Persons liable therefor, the Corporation shall refund the amount so collected (net of any expenses, including without limitation any legal fees incurred in connection therewith) pro rata to the Clearing Members that had been assessed to meet such Defaulted Obligation or nonpayment and had paid the amount so assessed.

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**EXHIBIT C**

NYCC By-Law

Section 5.4. Guaranty Fund

The Corporation shall establish and maintain a Guaranty Fund.

(a) Each Clearing Member (other than a Self-Clearing Clearing Member) shall deposit and maintain in the Guaranty Fund an amount calculated as follows:

(i) Divide the total original margin requirements for all futures contracts, options and other contracts or instruments traded on or subject to the rules of each of the Exchanges which were cleared for such Clearing Member by the Corporation for the period of six months ending the date as of which the calculation

is made, by the total original margin requirements for all such futures contracts, options and other contracts or other instruments which were cleared for all Clearing Members by the Corporation during such six-month period, and multiply the resultant fraction by ⅕ of the total amount then on deposit in the Guaranty Fund as of such date.

(ii) Divide the original margin requirements for the total daily gross open interest in futures contracts, options and other contracts or instruments carried by the Corporation during such six-month period for such Clearing Member by the total original margin requirements for the total daily gross open interest in all such futures contracts, options and other contracts or instruments carried by the Corporation for all Clearing Members during such six-month period, and multiply the resultant fraction by ⅘ of the total amount then on deposit in the Guaranty Fund as of such date.

(iii) For each Clearing Member, the amount to be deposited and maintained in the Guaranty Fund shall be the sum of the amounts computed pursuant to subparagraphs (i) and (ii), provided that:

(A) (except as provided in paragraph (b) of this Section 5.4), no Clearing Member shall be required to deposit or maintain in the Guaranty Fund less than the greater of an amount equal to 10% of its Capital or $300,000; and

(B) no Clearing Member shall be required to deposit or maintain in the Guaranty Fund more than the lesser of an amount equal to 20% of its Capital or $3,500,000.

(iv) The amount of each Clearing Member's required Guaranty Fund deposit shall be recalculated as of the last Business Day of each March, June, September and December.

(v) As used in the paragraph (a):

(A) The term "Capital" with respect to any Clearing Member shall mean the lesser of the amount of its actual Capital or such amount as may have been designated by it for Position Limit purposes pursuant to Section 5.6(a)(v) of these By-Laws; and

(B) In calculating original margin requirements, option liquidation values are not to be included.

(b) Each Self-Clearing Clearing Member shall deposit and maintain $30,000 in the Guaranty Fund, all of which shall be in the form of cash.

(c) Except as provided in paragraph (b) of this Section 5.4, deposits in the Guaranty Fund may be made by any Clearing Member in the form of cash or securities which are direct obligations of the United States Government, and which have such maximum time to maturity as the Corporation may prescribe; providing that each Clearing Member shall deposit a minimum of $50,000 in the form of cash. Any such securities shall be valued in accordance with such methodology as may be adopted by the Board.

(d) Guaranty Fund deposits shall be held in a bank approved for the purpose by the Corporation, in an account or accounts separate from all other cash and securities held by the Corporation. The Corporation shall have the sole right to withdraw cash or securities from, or to authorize the sale or other disposition of any securities held in, such account or accounts subject to the rights of any assignee, pledgee or holder of a security interest in the Guaranty Fund or any cash or securities therein.

(e) So long as any Person is a Clearing Member and thereafter for the period until the Corporation returns such person's Guaranty Fund deposits as provided in paragraph (i) of this Section 5.4, the Guaranty Fund deposits of such person may be applied by the Corporation:

(i) against any amounts that become due from such Person to the Corporation for any reason (including but not limited to original margin, variation margin, option premiums, dues, assessments, fines and reimbursement of any amounts paid by the Corporation to a Cross Margining Clearing Organization under any Cross Margining Program) at any time it was a Clearing Member and for a period of six months after it ceases being a Clearing Member;

(ii) against any amounts that are charged as provided in or pursuant to Section 5.5 of these By-Laws against the Guaranty Fund deposits of all Clearing Members at any time that such Person was a Clearing Member and for a period of six months thereafter; and

(iii) to provide such funds, on such terms and conditions, as the Board in its discretion, acting by a vote of not less than three-fourths of all directors eligible to vote, may deem necessary or appropriate to facilitate the transfer of customer accounts from a Clearing Member experiencing financial difficulty to another Clearing Member, if the Board shall determine by such vote that to do so is in the best interests of the Corporation.

(f) The Corporation may at any time and from time to time assign, pledge, repledge or otherwise create a lien on or security interest in, the Guaranty Fund and/or the cash, securities and other property held in the Guaranty Fund to secure the repayment of funds borrowed by the Corporation (plus interest, fees and other amounts payable in connection therewith). Any such borrowing shall be on terms and conditions deemed necessary or advisable by the Corporation (including the collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Clearing Member to the Corporation for which such cash, securities or other property was pledged to or deposited with the Corporation. Any funds so borrowed shall be used and applied by the Corporation solely for the purposes for which cash, securities and other property held in the Guaranty Fund are authorized to be used pursuant to these By-Laws and the Rules; provided that the failure of the Corporation to use such funds in accordance with this subsection shall not impair any of the rights or remedies of any assignee, pledgee or holder of any such lien or

security interest. Cash, securities and other property held in the Guaranty Fund, subject to the rights and powers of the Corporation with respect thereto as set forth in these By-Laws, the Rules and any agreements between any Clearing Member and the Corporation, and subject to the rights and powers of any person to which the Guaranty Fund or any cash, securities or other property held therein shall have been assigned, pledged, repledged or otherwise subjected to a lien or security interest, shall remain the property of the respective Clearing Members depositing such cash securities and other property.

(g) Subject to the rights of any assignee, pledgee or holder of a lien or security interest as provided in subsection (f) of this Section 5.4, if at any time the amount of any cash, plus the value of any securities, on deposit in the Guaranty Fund for any Clearing Member

(i) shall exceed the amount required to be on deposit for such Clearing Member by more than such amount as the Board may prescribe, the Corporation will return the excess to such Clearing Member upon its written request.

(ii) shall be less than the amount required to be on deposit for such Clearing Member, such Clearing Member shall restore the deficiency (including, without limitation, a deficiency caused by the application of such Clearing Member's deposits in the Guaranty Fund as described in Section 5.4(e) of these By-Laws) on demand; provided, however, that a Clearing Member that has withdrawn as a Clearing Member shall not be required to restore a deficiency occurring after the

effective date of its withdrawal; and, further provided, that if and to the extent that any such deficiency is caused by the application of such Clearing Member's deposits in the Guaranty Fund to meet a Monetary Default pursuant to Section 5.5(b)(iii) of these By-Laws, any amounts deposited with the Corporation to restore such deficiency shall not be applied to further meet the same Monetary Default.

(h) Any interest earned on any securities deposited in the Guaranty Fund by a Clearing Member shall belong and be credited to such Clearing Member. The Corporation may invest any cash deposited in the Guaranty Fund in securities which are direct obligations of the United States Government and may engage in repurchase transactions with any cash or securities on deposit. Any interest, capital gain or other income earned on any such securities shall belong and be credited to the Corporation.

(i) Subject to the rights of any assignee, pledgee or holder of a lien or security interest as provided in subsection (f) of this Section 5.4, whenever a Person ceases to be a Clearing Member, the Corporation shall return to such Person the amount of cash and securities on deposit in the Guaranty Fund for such Person; provided, however, that the Corporation shall not be required to so return such cash and securities after the effective date of the termination of such Clearing Membership until six months after the last date on which such Person either had any open positions carried by the Corporation or had any futures contracts, options or other contracts or instruments cleared by the Corporation (or such longer period as the Board may prescribe),

unless the Corporation receives guaranties or other security satisfactory to it to assure the availability of any amounts to be applied as provided in subsection (e) of this Section 5.4.

(j) If the Guaranty Fund or any part thereof is lost as a result of the insolvency of any bank or other depository, embezzlement, defalcation or any reason other than use pursuant to Section 5.5 of these By-Laws, such loss may, in the discretion of the Board, be restored by application of the following sources of funds in the order listed (each such source to be fully utilized before the next following source is applied):

(i) such portion, if any, of the surplus of the Corporation as the Board determines to be available for such purpose; and

(ii) assessments levied by the Corporation upon the Clearing Members, which assessments shall be paid to the Corporation at such time and in such manner as the Board may specify. The amount of a Clearing Member's assessment shall be the amount derived by multiplying the loss by a fraction, the numerator of which shall be the amount of such Clearing Member's required deposit in the Guaranty Fund on the day preceding the loss and the denominator of which shall be the total amount required to be in the Guaranty Fund on such day.

(k) In the event that the Corporation accepts a transfer of cash or securities from a guaranty fund of any other clearing organization of which a Clearing Member is or was a member to satisfy in whole or in part the obligations of such

Clearing Member to deposit and maintain funds in the Guaranty Fund, the Corporation shall (to the extent of the amount of the cash and the value of the securities so transferred) guaranty payment by such Clearing Member to such clearing organization of any amount, the payment of which would have been secured by such Clearing Member's deposit in the guaranty fund of such other clearing organization. If the Corporation is required to make any payment pursuant to such guaranty as to any Clearing Member, the Corporation may withdraw the amount thereof out of the Guaranty Fund, and such Clearing Member will restore the amount so withdrawn on demand.

(l) In the event that the Guaranty Fund or any part thereof shall have been applied as described in paragraph (e) of this Section 5.4 or shall have been lost as described in paragraph (j) of this Section 5.4, and the Corporation shall thereafter recover any amount so applied or lost from any Person liable therefor, the amount of such recovery (after deducting any expenses (including without limitation legal fees and expenses incurred in connection therewith) shall be credited to the Guaranty Fund deposits of each Clearing Member in that proportion which the amount required to be on deposit by such Clearing Member bears to the amount required to be on deposit by all Clearing Members as of the date upon which such application took place or such loss was incurred.

(m) Any expense (including without limitation legal fees and expenses) incurred by the Corporation in connection with the deposit by a Clearing Member of assets into the Guaranty Fund, or the return thereof to such Clearing Member, may at

the option of the Corporation be charged to such Clearing Member.

---

**EXHIBIT D**

**NEWS RELEASE**

[LOGO]
Four World Trade Center,
New York, NY 10048
Tel: 212 742 6000 Fax: 212 748 4320

**FOR IMMEDIATE RELEASE**

Contact:
Terence Gordon
(212) 742-6106

**NYBOT BOARD APPROVES RESOLUTION REGARDING CLEARING MEMBER SUSPENSION**

*– NYBOT President Responds to NYMEX Lawsuit Against Exchange –*

(New York, NY May 17, 2000) – At a special meeting this afternoon, the Board of Directors of the New York Board of Trade (NYBOT) approved a plan designed to "make whole" traders and all other customers who sustained losses as a result of Klein & Co. Futures, Inc.'s suspension of membership in the exchanges and the New York Clearing Corporation (NYCC).

Specifically, NYBOT will pay the innocent customers of Klein whose funds were utilized by Klein to meet its obligations to the Clearing Corporation.

"I am pleased at the speed and sense of fairness with which the NYBOT Board has moved in addressing this serious issue," stated Mark D. Fichtel, NYBOT President and CEO. "The board obviously has taken into account the concerns and best interests of our members, and the

members of other exchanges, who cleared through Klein & Co. Futures, Inc. by deciding to 'make whole' the losses they incurred this week."

"I am especially surprised and disappointed that NYBOT has been served with a lawsuit by NYMEX on behalf of its members who cleared through Klein," stated Mr. Fichtel. "Through conversations with their senior management today, they were made aware of the valiant efforts of our Board to do the right thing. They are falsely looking like a wronged party through this outright grandstanding, ignoring their own history with the Volume Investors Corp. debacle."

"In fact," added Mr. Fichtel, "as a Designated Self Regulatory Organization, (DSRO) NYMEX was in a position to monitor Klein's activities. In that regard, they failed to pick up on Klein's treatment of customer funds that led to the serious incidents earlier this week."

More recently, in 1999, NYMEX's COMEX members were adversely affected by huge out-trades from heavy volume trading in gold options that did not clear for several days. "Where was NYMEX's oversight when that was happening?" questioned Mr. Fichtel.

The New York Board of Trade (NYBOT) is the parent company of the Coffee, Sugar & Cocoa Exchange, Inc. (CSCE) and the New York Cotton Exchange (NYCE). Through its two exchanges and subsidiaries and division, which include Citrus Associates, FINEX and the New York Futures Exchange (NYFE), NYBOT offers a variety of agricultural, financial and index products. The Cantor Exchange (CX), a joint venture with eSpeed, Inc, provides the first full-time electronic market for U.S. Treasury and Agency futures.

***NYBOT can be found on the web at www.nybot.com.***

\# \# \#

New York Board of Trade is the parent company of the Coffee, Sugar & Cocoa Exchange, New York Cotton Exchange, Citrus Associates, FINEX, NYFE and the Cantor Exchange

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**EXHIBIT E**

**New York Futures Exchange Guide Rule 137**

**[¶ 2285] Expenses of Lawsuits Brought Against the Exchange by Members**

Rule 137 Any Member who institutes a lawsuit or other similar proceeding against the Exchange, or any of its officers, Board of Managers or committee members, agents or employees in any court of law or otherwise and who fails to prevail in such lawsuit or proceeding shall pay to the Exchange any and all reasonable expenses and disbursements, including attorney's fees and any statutory costs, incurred by the Exchange in the defense of such lawsuit or proceeding.

---

NYCC BY-LAW

Section 6.5. Exculpation and Reimbursement of Corporation

(a) NEITHER THE CORPORATION, NYBT NOR ANY EXCHANGE, NOR ANY DIRECTOR, COMMITTEE MEMBER, OFFICER, AGENT OR EMPLOYEE OF THE CORPORATION, NYBT OR ANY EXCHANGE, SHALL BE LIABLE TO ANY CLEARING MEMBER FOR ANY DAMAGES ARISING OUT OF OR IN CONNECTION

WITH ANY ERROR, ACT OR OMISSION ON THE PART OF THE CORPORATION, OR ON THE PART OF ANY PERSON IN THE CAPACITY OF MEMBER OR IN THE CAPACITY OF DIRECTOR, COMMITTEE MEMBER, OFFICER, AGENT OR EMPLOYEE OF A MEMBER OR OF THE CORPORATION, WHETHER OR NOT SUCH DAMAGES ARE DUE TO NEGLIGENCE, UNLESS SUCH ERROR, ACT OR OMISSION WAS THE RESULT OF WILLFUL OR WANTON CONDUCT OR WAS IN BAD FAITH.

(b) Any Clearing Member which institutes an action or proceeding against the Corporation, or any of the officers, directors, committee members, agents or employees of the Corporation, and which fails to prevail in such action or proceeding, shall reimburse the Corporation and such officer, director, committee member, agent or employee, for any and all costs or expenses (including but not limited to attorneys' fees, expenses of investigation and amounts paid by way of indemnifying any officers, directors, employees or other persons by the Corporation) incurred in connection with the defense of such action or proceeding.

---

New York Cotton Exchange
Rule 5.09 effective until 7/24/00

**RULE 5.09 EXCHANGE DEFENSE EXPENSES AND PROSECUTION EXPENSES**

(a) *Exchange Defense Expenses* –

Any member who fails to prevail in a lawsuit or similar proceeding instituted by that member against the Exchange or any of its officers, directors, committee members, agents or employees

must pay to the Exchange all reasonable expenses, including attorney's fees, incurred by the Exchange in the defense of such proceeding.

(b) *Exchange Prosecution Expenses* –

Any member who, after notice and opportunity for hearing, has been found to have violated any By-Law or Rule of the Exchange, may, in the discretion of the Supervisory Panel appointed in the matter, be required to pay to the Exchange an amount equal to any and all expenses incurred by the Exchange in connection with the prosecution of such violation, in addition to any penalty which may be imposed upon such member by virtue of the violations found by the Hearing Panel.

---

New York Cotton Exchange
By-Law 6.37 effective date 7/24/00

**Rule 6.37 Expenses of Lawsuits Brought Against the Exchange by Members**

Any member who institutes a lawsuit or other similar proceeding against the Exchange, or any of its officers, Board of Managers or committee members, agents or employees in any court of law or otherwise and who fails to prevail in such lawsuit or proceeding shall pay to the Exchange any and all reasonable expenses and disbursements, including attorney's fees and any statutory costs, incurred by the Exchange in the defense of such lawsuit or proceeding.

---

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Case # 00 Civ. 5563 (GBD)

[Caption Omitted In Printing]

[Exhibit E to Affidavit in Opposition of
Mark R. Alonso, dated November 30, 2000]

* * *

**New York Clearing Corporation**
**By-Laws & Rules**

. . . the by-laws & rules of the New York Clearing Corporation . . .

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# BY-LAWS OF COMMODITY CLEARING CORPORATION (A New York Corporation)

## ARTICLE I

### Definitions; Offices; Time References

¶ 11,001

**Section 1.1.** ***Definitions***

Unless the context otherwise clearly requires, the following terms as used in the By-Laws and Rules shall have the following meanings:

**Affiliated Person**

With respect to any Entity, any Person who Controls, is Controlled by or is under common Control with such Entity, and, without limiting the generality of the foregoing, any partner, trustee, officer, director or employee (whether or not having Control) of such Entity; with respect to any individual, any Person of which such individual is a partner, member, trustee, officer, director or employee or has Control, and any Person who Controls, is Controlled by or is under common Control with such Person.

**Assessment Amount**

The meaning set forth in Section 5.5(b).

**BCL**

The Business Corporation Law of the State of New York, as in effect from time to time.

**Board**

Board of Directors of the Corporation.

**Business Day**

A day on which the Corporation is open to accept Contracts for clearance.

**By-Laws**

The By-Laws of the Corporation, as in effect from time to time.

**Capital**

Adjusted Net Capital computed in accordance with Commission Regulation 1.17, except that unsecured receivables from any bank organized under the laws of the United States or of any state shall be included as current assets, so long as such receivables are outstanding no longer than 30 days from the date they are accrued. For purposes of Sections 5.4(a) and 5.5 of these By-Laws, the Capital of any Clearing Member shall be computed as of the date of either (a) the most recent financial reports provided by such Clearing Member to the Corporation in accordance with these By-Laws and the Rules, or (b) such Clearing Member's latest audited financial statements, whichever will result in higher Capital for such Clearing Member.

**CCC**

The Corporation.

**Certificate of Incorporation**

The Certificate of Incorporation of the Corporation, as in effect from time to time.

**CFCCNY**

Commodity Futures Clearing Corporation of New York, a corporation organized and existing under the NPCL, its successor and any permitted assign.

**CFFE**

Cantor Financial Futures Exchange, Inc. a corporation organized and existing under the NPCL, its successor and any permitted assign.

**CFFE Clearing Member**

A Clearing Member which only has the privilege to clear Contracts effected on or subject to the rules of CFFE.

**Chairman**

The Chairman of the Board.

**Citrus**

Citrus Associates of the New York Cotton Exchange, Inc., a corporation existing under the NPCL, its successor and any permitted assign.

**Class B Clearing Member**

A Clearing Member which has the privilege to clear Contracts in financial instruments but only as part of arbitrage transactions for its proprietary account with an Arbitrage Bank.

**Clearing Member**

A Person who or which pursuant to these By-Laws has the privilege to clear with the Corporation Contracts effected on or subject to the rules of an Exchange.

**Commission**

Commodity Futures Trading Commission and any successor agency.

**Commission Regulation**

Any rule or regulation adopted by the Commission, and any interpretation thereof or order thereunder issued by the Commission or the staff thereof.

**Contract**

A futures contract, option or other contract or instrument for which the Corporation acts as a clearing organization.

**Control**

The power to direct or cause the direction of the management or policies of a Person, whether through ownership of securities, by contract or otherwise.

**Corporation**

Commodity Clearing Corporation, a corporation existing under the BCL, its successor and any permitted assign.

**Cross Margining Clearing Organization**

A clearing organization that has entered into a cross-margining agreement with the Corporation.

**Cross Margining Program**

Any program established under a cross margining agreement between the Corporation and one or more Cross Margining Clearing Organizations pursuant to which Clearing Members receive Cross Margining treatment.

**CSCE**

Coffee, Sugar & Cocoa Exchange, Inc., a corporation existing under the NPCL, its successor and any permitted assign.

**Defaulted Obligation**

The meaning set forth in Section 5.5(a).

**Defaulting Clearing Member**

The meaning set forth in Section 5.5.

**Effective Date**

The date upon which these By-Laws become effective.

**Emergency**

The meaning set forth in Section 7.5(a)

**Entity**

Any Person other than an individual.

**Exchange**

CSCE, NYCE, Citrus, NYFE, CFFE, any other board of trade, exchange or market for which the Corporation acts as a clearing organization, and their respective successors, by merger or otherwise.

**Former Clearing Organization**

With respect to any Exchange, any clearing organization (including the Corporation) which cleared transactions on or subject to the rules of such Exchange within six months prior to the Operational Date.

**Guaranty Fund**

The guaranty fund established as provided in Section 5.4.

**Listing Exchange**

With respect to any Contract, the Exchange on or subject to the rules of which such Contract is traded.

**Monetary Default**

The meaning set forth in Section 5.5.

**NYBT**

Board of Trade of the City of New York, Inc., a corporation organized and existing under the NPCL, its successor and any permitted assign.

**NYCE**

New York Cotton Exchange, a corporation existing under the NPCL, its successor and any permitted assign.

**NYFE**

New York Futures Exchange, Inc., a corporation organized and existing under the BCL, its successor and any permitted assign.

**NPCL**

The Not-for-Profit Corporation Law of the State of New York, as in effect from time to time.

**Operational Date**

The first day on which the Corporation clears Contracts traded on or subject to the rules of CSCE.

**Person**

An individual, sole proprietorship, partnership, limited liability company, association, firm, trust, corporation or other entity, as the context may require.

**Physical Emergency**

The meaning set forth in Section 7.5(b).

**Position Limit**

The limit established by the Board pursuant to Section 5.6(a) on the total Net Interest and/or the total Offset Interest that any Clearing Member may have open with the Corporation at any one time.

**President**

The president of the Corporation.

**Rules**

The Rules of the Corporation adopted by the Board as authorized by these By-Laws, the interpretations, resolutions, orders and directives of the Board thereunder and the procedures adopted by the Corporation as in effect from time to time.

**Self-Clearing Clearing Member**

A Clearing Member entitled under these By-Laws to clear with the Corporation Contracts effected on or subject to the rules of one or more Exchanges, but only for such Clearing Member's own account.

**Self-Regulatory Organization**

The Corporation and any self-regulatory organization as that term is defined in Commission Regulation 1.3(ee).

**Shareholder**

A holder of record of one or more shares in the Corporation.

**Vice Chairman**

Any Vice Chairman of the Board.

**Vice President**

Any Vice President of the Corporation.

Amended by the Board April and May 1999; effective January 2000.

**¶ 11,011**

**Section 1.2. *Principal and Other Offices***

The principal office of the Corporation shall be located in the City, County and State of New York. The Corporation may have offices at such other places within or without the State of New York or within or without the United States as the Board from time to time may designate or the business of the Corporation may require.

**¶ 11,013**

**Section 1.3. *Date and Time References***

All references to dates, times or time periods in the By-Laws and Rules shall refer to, or be measured in accordance with, New York City time.

## ARTICLE II

## Shareholders

¶ 11,015

**Section 2.1.** ***Share Certificate***

Shares in the Corporation shall be represented by share certificates in such form as the Board may approve.

¶ 11,017

**Section 2.2.** ***Place of Meetings***

Special and annual meetings of any class of Shareholders shall be held at the principal [sic] office of the Corporation or at such other place within or without the State of New York as may be fixed by the Board and set forth in the notice of the meeting.

¶ 11,019

**Section 2.3.** ***Annual Meetings***

The annual meeting of each class of Shareholders shall be held for the transaction of such business as may properly come before it at 3:30 p.m. on the third Thursday of June in each year if not a legal holiday and, if a legal holiday, on the next following Business Day not a legal holiday.

¶ 11,021

**Section 2.4.** ***Special Meetings***

Special meetings of Shareholders may be called at any time by the Chairman, the President, or a majority of the members of the Board present at a meeting thereof

(provided a quorum is present). Special meetings shall be called by the Secretary on receipt of a written demand therefor, setting forth the matter or matters to be considered at such meeting, duly executed by the holders of not less than 10% of the votes of shares entitled to vote at the meeting being called.

**¶ 11,023**

**Section 2.5. *Notices***

Whenever under the provisions of this chapter Shareholders are required or permitted to take any action at a meeting, written notice shall be given stating the place, date and hour of the meeting and, unless it is the annual meeting, indicating that it is being issued by or at the direction of the person or persons calling the meeting. Notice of a special meeting shall also state the purpose or purposes for which the meeting is called. If, at any meeting, action is proposed to be taken which would, if taken, entitle Shareholders fulfilling the requirements of section 623 of the BCL to receive payment for their shares, the notice of such meeting shall include a statement of that purpose and to that effect and shall be accompanied by a copy of section 623 of the BCL or an outline of its material terms. A copy of the notice of any meeting shall be given, personally or by first class mail, not fewer than ten nor more than sixty days before the date of the meeting, provided, however, that a copy of such notice may be given by third class mail not fewer than twenty-four nor more than sixty days before the date of the meeting, to each Shareholder entitled to vote at such meeting. If mailed, such notice is given when deposited in the United States mail, with postage thereon prepaid, directed to the Shareholder at his address as it appears on

the record of Shareholders, or, if he shall have filed with the secretary of the Corporation a written request that notices to him be mailed to some other address, then directed to him at such other address. An affidavit of the secretary or other person giving the notice or of a transfer agent of the Corporation that the notice required by this section has been given shall, in the absence of fraud, be prima facie evidence of the facts therein stated.

**¶ 11,025**

**Section 2.6. *Quorum***

(a) Except as may be otherwise provided in the Certificate of Incorporation or in these By-Laws or by law, the holders of one-third of the votes of shares entitled to vote thereat shall constitute a quorum at any meeting of Shareholders for the transaction of business.

(b) Shareholders present in person or by proxy at any meeting may adjourn the meeting despite the absence of a quorum. When a meeting is adjourned to another time or place, it shall not be necessary to give a notice of the adjourned meeting to any of the Shareholders who were present at the meeting in person or by proxy if the time and place to which the meeting is adjourned is announced at the meeting, but in any event notice shall be given to any Shareholder who was not so present not less than one Business Day prior to the date of the adjourned meeting. At the adjourned meeting any business may be transacted that might have been transacted on the original date of the meeting.

¶ 11,027

**Section 2.7. *Voting***

At every meeting of Shareholders, each Shareholder entitled to vote may vote in person or by proxy. Except as provided in the Certificate of Incorporation and these By-Laws, or as required by law, all corporate action to be taken by vote of the Shareholders or of any class of Shareholders shall be authorized by a majority of the votes cast at a meeting of Shareholders by the Shareholders entitled to vote thereon.

¶ 11,031

**Section 2.8. *Proxies***

Every Shareholder entitled to vote at a meeting of Shareholders or to express consent or dissent without a meeting may authorize any person or persons to act for the Shareholder by proxy. Every proxy must be signed by the Shareholder or the Shareholder's attorney-in-fact. No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the Shareholder executing the proxy except as otherwise provided by law.

¶ 11,033

**Section 2.9. *Written Consents***

Whenever Shareholders are required or permitted to take any action by vote, such action may be taken without a meeting on written consent, setting forth the action so taken, signed by the holders of all outstanding shares entitled to vote thereon.

## ARTICLE III

## Directors

¶ 11,031

**Section 3.1.** ***Duties and Powers***

The Board shall have control and management of the affairs and business of the Corporation and shall have all the powers and duties set forth in the BCL. Without limiting the generality of the foregoing, the Board shall have the power to:

(a) adopt, amend and repeal such Rules, not contrary to the provisions of the Certificate of Incorporation, these By-Laws or applicable law, with respect to the conduct of the business of the Corporation as will, in its judgment, best promote and safeguard the interests of the Corporation; and

(b) render interpretations of the By-Laws and the Rules, which shall be binding on all persons having dealings with the Corporation directly or through Clearing Members.

The fact that certain powers of the Board are specified in these By-Laws does not in any way limit the powers of the Board, whether or not specified in these By-Laws, except as may otherwise be expressly provided in the Certificate of Incorporation, the By-Laws or applicable law.

¶ 11,033

**Section 3.2.** ***Number of Directors***

The number of directors shall be 11.

**¶ 11,035**

**Section 3.3. *Qualifications of Directors***

(a) Each director shall be at least eighteen (18) years of age and shall not be ineligible to serve pursuant to paragraph (c) of this Section 3.3.

(b) For purposes of paragraph (c) of this Section 3.3, the following definitions shall apply:

(i) "Disciplinary Committee" means any committee of the Board or the Corporation empowered to bring disciplinary proceedings against a Clearing Member, to impose sanctions on a Clearing Member or to hear appeals thereof.

(ii) "Disciplinary Offense" means:

(A) any violation of the rules of a Self-Regulatory Organization except those rules relating to (1) decorum or attire, (2) financial requirements, or (3) reporting or recordkeeping, unless resulting in fines aggregating more than $5,000 in any calendar year;

(B) any rule violation described in subparagraph (b)(ii)(A) of this Section 3.3 which involves fraud, deceit or conversion or results in a suspension from membership in, or in expulsion from, a Self-Regulatory Organization;

(C) any violation of the Commodity Exchange Act or a Commission Regulation promulgated thereunder; or

(D) any failure to exercise supervisory responsibility with respect to acts described in subparagraphs (b)(ii)(A) through (C) of this Section 3.3, when such failure is itself a violation of either the rules of a Self-Regulatory

Organization, the Commodity Exchange Act, or a Commission Regulation promulgated thereunder.

(iii) "Final Decision" means:

(A) a decision of a Self-Regulatory Organization which cannot be further appealed within the Self-Regulatory Organization, is not subject to the stay of the Commission or a court of competent jurisdiction, and has not been reversed by the Commission or any court of competent jurisdiction; or

(B) any decision by an administrative law judge, a court of competent jurisdiction or the Commission, which has not been stayed or reversed.

(iv) "Settlement Agreement" means any agreement whereby a person consents to the imposition of sanctions approved by the Board or a Disciplinary Committee or by another Self-Regulatory Organization, a court of competent jurisdiction or the Commission.

(c) No individual shall be eligible to serve on the Board or a Disciplinary Committee of the Corporation if such individual:

(i) was found within the prior three years by a Final Decision in any action or proceeding brought by the Commission, any other governmental agency or any Self-Regulatory Organization to have committed a Disciplinary Offense;

(ii) entered into a Settlement Agreement within the prior three years in which any of the findings or, in the absence of such findings, any of the acts charged (and not withdrawn) included a Disciplinary Offense;

(iii) currently is suspended from trading on any contract market, is suspended or expelled from membership in any Self-Regulatory Organization, is serving any sentence or probation or owes any portion of a fine imposed pursuant to either:

(A) a finding by a Final Decision in any action or proceeding brought by the Commission, any other governmental agency or any Self-Regulatory Organization that such person committed a Disciplinary Offense; or

(B) a Settlement Agreement in which any of the findings or, in the absence of such findings, any of the acts charged (and not withdrawn) included a Disciplinary Offense;

(iv) currently is subject to an agreement with the Commission or any Self-Regulatory Organization not to apply for registration with the Commission or membership in any Self-Regulatory Organization;

(v) currently is subject to, or has had imposed on such person, within the prior three years, a Commission registration revocation or suspension in any capacity for any reason, or has been convicted within the prior three years of any of the felonies listed in Section 8a(2)(D)(ii) through (iv) of the Commodity Exchange Act; or

(vi) currently is subject to a denial, suspension or disqualification from serving on the disciplinary committee, arbitration panel or governing board of any "self-regulatory organization" as that term is defined in Section 3(a)(26) of the Securities Exchange Act of 1934.

(d) Any individual who is a member of the Board or a Disciplinary Committee shall immediately notify the

President of any Final Decision which subjects such person to disqualification pursuant to Section 3.3(c).

¶ 11,037

**Section 3.4.** ***Election, Appointment and Term of Office***

(a) The initial Board shall consist of four directors appointed by CCC (who shall be Affiliated Persons of clearing members of CCC), four directors appointed by CFCCNY (who shall be Affiliated Persons of clearing members of CFCCNY), one director jointly appointed by CCC and CFCCNY (who shall be an Affiliated Person of a clearing member of both CCC and CFCCNY) and two directors appointed by NYBT. Two of the directors so appointed by CCC, two of the directors so appointed by CFCCNY and two of the directors appointed by NYBT shall have a term of office expiring at the first annual meeting of shareholders which takes place not less than one year after the Operational Date, and until their respective successors have been elected or appointed and have taken office. Two of the directors so appointed by CCC, two of the directors so appointed by CFCCNY, the director jointly appointed by CCC and CFCCNY and one of the directors appointed by NYBT shall have a term of office expiring at the first annual meeting of shareholders following the annual meeting referred to in the preceding sentence.

(b) At each annual meeting of Shareholders which takes place not less than one year after the Operational Date the Shareholders shall elect directors to succeed those whose terms of office expire at such meeting. Not less than 90 days prior to each such annual meeting, the board shall appoint a Nominating Committee consisting of

five Associated Persons of Clearing Members, none of whom shall be members of the Board. Not less than 80 days prior to such annual meeting, the Nominating Committee shall nominate one or more candidates to be recommended by the Clearing Members to succeed each of the directors whose terms will expire at such annual meeting (other than the director appointed by NYBT or any successor to such director) and shall report the names of such candidates to the President. At least one of such candidates shall be in the category of an Affiliated Person of a Clearing Member having Capital of $25,000,000 or less, and at least one of such candidates shall be in the category of an Associated Person of a Clearing Member having Capital of $100,000,000 or more. The President shall forthwith notify the Clearing Members of the names of the candidates so nominated. Any five Clearing Members may nominate any other candidates by filing a petition with the President not later than 70 days prior to such annual meeting. The list of all candidates nominated as hereinbefore provided shall be sent to the Clearing Members, and a meeting shall be held at which Clearing Members may vote for candidates to be recommended to succeed each of the directors whose terms are expiring at such annual meeting (other than the director appointed by NYBT or any successor to such director). The results of such voting shall be reported to the Shareholders, but shall be advisory only. At the annual meeting, the Shareholders shall elect directors who may but need not include any or all of the individuals so recommended by the Clearing Members; provided that all but one of the directors so elected must be Affiliated Persons of Clearing Members, at least one of whom shall be in the category of an Affiliated Person of a Clearing Member having Capital of $10,000,000 or less, and at least one of whom shall be in

the category of an Associated Person of a Clearing Member having Capital of $100,000,000 or more.

(c) The directors elected at each annual meeting shall hold office for a term of two years and until their respective successors have been elected and have taken office.

¶ 11,039

**Section 3.5. *Meetings***

(a) The annual meeting of the board shall be held on such day and at such time as the Board may fix, for the purpose of electing officers and transacting such other business as may properly come before the meeting.

(b) Regular meetings of the Board may be held at such time and place as may be fixed by the Board.

(c) Special meetings of the Board may be called at any time by the Chairman or the President and shall be called by the President whenever requested to do so by any two directors. Special meetings shall be held at such time and place within New York City as may be specified by the Chairman.

(d) A majority of the directors present, whether or not a quorum is present, may adjourn any meeting of directors to another time and place.

¶ 11,041

**Section 3.6. *Quorum***

A majority of the members of the Board shall constitute a quorum for the transaction of business or of

any specified item of business, except that four members of the Board shall constitute a quorum for the taking of emergency action pursuant to ARTICLE VII of these By-Laws.

**¶ 11,043**

**Section 3.7. *Action by the Board***

Except as otherwise provided by law or these By-Laws, the vote of a majority of the directors present at the time of the vote, if a quorum is present at such time, shall be the act of the Board.

**¶ 11,045**

**Section. 3.8. *Notices***

All meetings of the Board shall be held on notice to the directors. Special meetings of the board shall be held upon not less than one hour's notice stating the purpose, place, date and hour of the meeting and specifying the person or persons at whose direction the meeting is called. At any special meeting of the Board, only the matter stated in the notice of the meeting may be acted upon at such meeting, unless an action on any other matter is consented to by all of the members of the Board. A notice pursuant to this Section 3.8 may be given orally or in writing, by personal delivery, by telephone, by telefacsimile or by electronic mail.

**¶ 11,047**

**Section 3.9. *Vacancies***

In case of any vacancy created by death, resignation, removal or disqualification of any director, such vacancy

may be filled by election of a successor by the Shareholders. Such successor shall be elected by a plurality of the votes cast at a meeting of the Shareholders entitled to vote on such successor. If such director was in one of the categories specified in Section 3.4(b), the successor must be in the same category. A person elected or appointed to fill a vacancy as a director shall hold office for the balance of the term of the director whose position such successor is filling.

¶ 11,049

**Section 3.10. *Removal***

(a) Any director may be removed with or without cause at any time by the Shareholders.

(b) A director who becomes ineligible to serve on the Board pursuant to Section 3.3(c) shall be automatically removed upon the occurrence of such ineligibility without any act of the Shareholders or the Board.

¶ 11,051

**Section 3.11. *Resignation***

Any director may resign at any time. A resignation shall be written and shall take effect at the time specified therein. If no time is so specified, a resignation shall take effect at the time of its receipt by the Corporation. The acceptance of a resignation shall not be necessary to make it effective. No resignation shall discharge any accrued obligation or duty of a director.

**¶ 11,053**

**Section 3.12. *Committees***

(a) The Board may designate from among its members an executive committee and any other committees, each consisting of three or more directors. To the extent permitted by law and as provided in the resolution adopted by the Board, each such committee may have all the authority of the Board.

(b) Each committee member shall serve at the direction and at the pleasure of the Board.

(c) Notwithstanding paragraph (a) above, the Board shall appoint an Agricultural Contracts Margin Committee and a Financial Contracts Margin Committee, each of which may be comprised of members of the Board and individuals who are not members of the Board. Each such committee shall have such powers as are specified from time to time in these By-Laws and/or the Rules.

Amended by the Board December 8, 1988; effective January 29, 1999[(c)].

**¶ 11,055**

**Section 3.13. *Written Consent in Lieu of Meeting***

Any action required or permitted to be taken by the Board or any committee may be taken without a meeting if all the members of the Board or the committee consent in writing to the adoption of a resolution authorizing the action. Such consent may be given by telefacsimile showing the signature of the person or persons giving consent.

¶ 11,057

**Section 3.14. *Conference Calls***

Any one or more members of the Board or a committee may participate in a meeting of the Board or such committee by means of a conference telephone or similar communications equipment allowing all persons participating in the meeting to hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

## ARTICLE IV

## Officers

¶ 11,059

**Section 4.1. *Titles***

The officers of the Corporation shall be a Chairman, one or more Vice Chairmen, a President, one or more Vice-Presidents, a Secretary and a Treasurer. Each officer shall be appointed by the Board. The Board also may appoint such other officers as it may from time to time deem appropriate, who shall have such authority and perform such duties as may be prescribed by the Board.

¶ 11,061

**Section 4.2. *Qualifications***

The Chairman and each Vice Chairman must be a director of the Corporation. Each officer other than the Chairman and any Vice Chairman must be a full time employee of the Corporation. Any two or more offices may be held by the same person.

¶ 11,063

**Section 4.3. *Compensation***

The Board shall establish the compensation of all officers. The board may establish the compensation of other employees and agents or may delegate such authority to one or more officers.

¶ 11,065

**Section 4.4. *Appointment and Term of Office***

Except as otherwise provided by law or by these By-Laws, each officer shall be appointed by the Board to hold office until the first meeting of the Board following the next annual meeting of Shareholders and until the successor of such officer is appointed and qualified.

¶ 11,067

**Section 4.5. *Chairman***

The Chairman shall preside at all meetings of Shareholders and of the Board and shall have such powers and shall perform such other duties as are set forth in these By-Laws or as may be specified by the Board. The Chairman also shall be a member *ex officio* of all committees of directors.

¶ 11,069

**Section 4.6. *Vice Chairman***

The Vice Chairman, in the absence or disability of the Chairman, shall have the powers and shall perform the duties of the Chairman. If there is more than one Vice

Chairman, the Board shall specify the order in which they shall so act. The Vice Chairman also shall have such powers and shall perform such duties as are set forth in these By-Laws or as may be specified by the Board.

**¶ 11,071**

**Section 4.7. *President***

The President shall supervise the business and affairs of the Corporation, subject to the direction of the Board. The President shall not be a member of the Board or a Shareholder. The President shall perform all duties customarily incident to the office of president.

**¶ 11,073**

**Section 4.8. *Vice President***

Except as may otherwise be prescribed by the Board, the Vice President, in the absence or disability of the President, shall have the power and shall perform the duties of the President. If there is more than one Vice President, the Board shall specify the order in which they shall so act. Each Vice President also shall have such powers and shall perform such duties as may be delegated to such Vice President by the President or prescribed by the Board.

**¶ 11,075**

**Section 4.9. *Secretary***

The Secretary shall keep the minutes of all meetings of the Board and Members. The Secretary shall give or cause to be given notice of all meetings of the Board and

the Members and all other notices required by law or the By-Laws. In the event of the absence of the Secretary or the refusal by the Secretary to do so, any such notice may be given by any person so directed by the President or by the directors or by the Member or Members upon whose request the meeting is called. The Secretary shall have charge of the corporate books and records. The Secretary shall have custody of the seal of the Corporation and shall affix the seal to all instruments requiring such seal when authorized by the Board or President and shall attest the same. In general, the Secretary shall perform all duties customarily incident to the office of secretary.

**¶ 11,077**

**Section 4.10. *Treasurer***

The Treasurer shall have custody of all funds and securities of the Corporation. The Treasurer shall enter or cause to be entered in the books of the Corporation to be kept for the purpose, full and accurate accounts of all monies received and paid out on account of the Corporation and, when required by the Chairman or the President, shall render a statement of the accounts. The Treasurer shall keep or cause to be kept such other books as will show a true record of the expenses, losses, gains, assets and liabilities of the Corporation. The Treasurer at all reasonable times shall exhibit the books and accounts to any director of the Corporation upon application at the office of the Corporation during business hours. In general, the Treasurer shall perform all duties customarily incident to the office of treasurer.

¶ 11,079

**Section 4.11. *Resignation***

Any officer may resign at any time. A resignation shall be written and shall take effect at the time specified therein. If no time is so specified, a resignation shall take effect at the time of its receipt by the President or Secretary of the Corporation. The acceptance of a resignation shall not be necessary to make it effective. No resignation shall discharge any accrued obligation or duty of an officer.

¶ 11,081

**Section 4.12. *Removal***

Any officer appointed by the Board may be removed as an officer (but not as a director) by the Board at any time with or without cause.

¶ 11,083

**Section 4.13. *Vacancies***

If the office of any officer becomes vacant, the Board may appoint any qualified person to fill such vacancy. Any person so appointed shall hold office for the unexpired term of the predecessor of such person and until the successor of such person is elected or appointed and qualified.

## ARTICLE V

## Clearing Members

¶ 11,085

**Section 5.1.** ***Status of Clearing Members***

(a) Only Clearing Members shall be entitled to clear Contracts with the Corporation, except that, if the Board so determines, the Corporation may clear contracts, options or other instruments for members of any other clearing organization in connection with the linkage of an Exchange with another board of trade, exchange or market which is not an Exchange. Each Clearing Member shall have the privilege of clearing with the Corporation all Contracts traded on or subject to the rules of each Exchange of which it is a member or member firm (or, in the case of CFFE Clearing Members, CFFE), whether for customer or proprietary account, as specified in paragraph (b) of this Section 5.1.

(b) The Board may designate Clearing Members, at their request, as CFFE Clearing Members, Class B Clearing Members or Self-Clearing Clearing Members, subject to the following:

(i) A CFFE Clearing Member may only clear Contracts effected on or subject to the rules of CFFE;

(ii) A Class B Clearing Member may only clear Contracts in such financial instruments as may be approved from time to time by the Board, but only as part of arbitrage transactions for its proprietary account with an Arbitrage Bank; and

(iii) A Self-Clearing Clearing Member may clear Contracts effected on or subject to the rules of an

Exchange, but only for the proprietary account of such Self-Clearing Clearing Member.

(c) Each Clearing Member shall have the privileges, rights and obligations provided for in and pursuant to these By-Laws and the Rules. Such privileges, rights and obligations may be terminated or altered in any respect at any time as provided in these By-Laws or the Rules.

¶ 11,087

**Section 5.2. *Eligibility Requirements***

To become and remain a Clearing Member and to have the privilege of clearing Contracts effected on or subject to the rules of one of more Exchanges, a Person must:

(a) Be either a member or a member firm of such Exchange or Exchanges, except that until March 7, 2000, CFFE Clearing Members need not be members or member firms of any Exchange, after which any CFFE Clearing Member which has not become a member or member firm of NYCE shall automatically and without any further act by the Corporation cease to be a CFFE Clearing Member;

(b) If an Entity, have one person, satisfactory to the Corporation, who is (i) a director, general partner, trustee or officer (or person occupying a similar status or performing similar functions), (ii) responsible for the clearing operations of such Person and (iii) authorized to act on behalf of such Person in all transactions with or involving the Corporation;

(c) Have Capital of at least $2,000,000 or, in the case of a Self-Clearing Member, $600,000;

(d) In the case of a Class B Clearing Member, be a non-bank entity associated with a single arbitrage bank approved by the Corporation for the purpose;

(e) In the case of a Self-Clearing Clearing Member, have been a self-clearing clearing member of either CCC or CFCCNY immediately prior to the Effective Date; and

(f) Have, in the judgment of the Board, such qualities of financial responsibility, operational capacity, experience, business integrity, reputation and competence as the Board, in its discretion, may consider necessary or appropriate to be a Clearing Member.

**¶ 11,089**

**Section 5.3.** ***Procedure for Becoming a Clearing Member***

(a) Any Person desiring to become a Clearing Member (including without limitation a CFFE Clearing Member, a Class B Clearing Member, or a Self-Clearing Clearing Member) must file an application with the Corporation in such form as the Corporation may prescribe, shall furnish such documents and information as the Corporation may request and shall pay such application fee as the Board may prescribe. The filing of any such application, documents and information, and the action by the Corporation with respect thereto, shall be as provided in the Rules.

(b) The Board shall have final authority to grant or deny an application to become a Clearing Member and shall deny the application of any Person which does not meet the eligibility requirements set forth in Section 5.2; provided, however, that if the Board proposes to deny any

such application, it shall so notify the applicant in writing, setting forth the grounds upon which the Board proposes to deny such application, and the applicant, upon written request made within ten days after the date of receipt of such notification, shall be entitled to a hearing before the Board. Any such hearing shall be conducted pursuant to rules and procedures adopted by the Board which, in the judgment of the Board, are sufficient to give such applicant an opportunity fully and fairly to present to the Board the applicant's reasons why the application should be granted.

(c) If the Board grants an application to become a Clearing Member, the Corporation shall promptly give the applicant written notice thereof, specifying each Exchange whose Contracts the applicant is entitled to clear. Such applicant shall become a Clearing Member at such time as the Applicant has (i) deposited such amount in the Guaranty Fund as may be required pursuant to Section 5.4 of these By-Laws, and (ii) filed with the Corporation such agreements, undertakings and documents as the Corporation may require; provided, however, that if such applicant has not complied with the foregoing provisions within 30 days after the applicant was given written notice of approval of its application, the application shall be deemed to have been withdrawn.

(d) If, in accordance with paragraph (b) of this Section 5.3, the Board denies an application to become a Clearing Member, the Corporation shall give the applicant written notice of the Board's decision, setting forth the grounds therefor, and such decision shall be the final action of the Corporation.

¶ 11,091

**Section 5.4. *Guaranty Fund***

The Corporation shall establish and maintain a Guaranty Fund.

(a) Each Clearing Member (other than a Self-Clearing Clearing Member) shall deposit and maintain in the Guaranty Fund an amount equal to the greater of:

(i) 10% of its Capital (which, solely for the purposes of this clause (i), shall mean the lesser of the amount of its actual Capital or such amount as may have been designated by it for Position Limit purposes pursuant to Section 5.6(a)(v) of these By-Laws); or

(ii) the amount calculated as follows:

(A) Divide the total number of futures contracts, options and other contracts or instruments traded on or subject to the rules of each of the Exchanges which were cleared for such Clearing Member by the Corporation and by any Former Clearing Organization for such Exchanges for the period of six months ending the date as of which the calculation is made, by the total number of futures contracts, options and other contracts or instruments involving such commodities which were cleared by the Corporation and any Former Clearing Organization during such six-month period, and multiply the resultant fraction by ⅕ of the total amount then on deposit in the Guaranty Fund.

(B) Divide the total daily gross open interest in futures contracts, options and other contracts or instruments carried by the Corporation and by any Former Clearing Organization during such six-month period for

such Clearing Member by the total daily gross open interest in futures contracts, options and other contracts or instruments carried by the Corporation and any Former Clearing Organization for all Clearing Members during such six-month period and multiply the resultant fraction by ⅘ of the total amount then on deposit in the Guaranty Fund.

(C) For each Clearing Member, add the amounts computed pursuant to subparagraphs (A) and (B);

provided, that (except as provided in paragraph (b) of this Section 5.4) no Clearing Member shall be required to deposit or maintain in the Guaranty Fund less than [Illegible]000 or more than $3,500,000. The amount of each Clearing Member's required Guaranty Fund deposit shall be recalculated as of the last Business Day each March, June, September and December.

(b) Each Self-Clearing Clearing Member shall deposit and maintain $30,000 in the Guaranty Fund, all of which shall be in the form of cash.

(c) Except as provided in paragraph (b) of this Section 5.4, deposits in the Guaranty Fund may be made by any Clearing Member in the form of cash or securities which are direct obligations of the United States Government, and which have such maximum time to maturity as the Corporation may prescribe; provided that each Clearing Member shall deposit a minimum of $50,000 in the form of cash. Any such securities shall be valued in accordance with such methodology as may be adopted by the Board.

(d) Guaranty Fund deposits shall be held in a bank approved for the purpose by the Corporation, in an account or accounts separate from all other cash and securities held by the Corporation. The Corporation shall have the sole right to withdraw cash or securities from, or to authorize the sale or other disposition of any securities held in, such account or accounts subject to the rights of any assignee, pledgee or holder of a security interest in the Guaranty Fund or any cash or securities therein.

(e) So long as any Person is a Clearing Member and thereafter for the period until the Corporation returns such person's Guaranty Fund deposits as provided in paragraph (i) of this Section 5.4, the Guaranty Fund deposits of such person may be applied by the Corporation:

(i) against any amounts that become due from such Person to the Corporation for any reason (including but not limited to original margin, variation margin, option premiums, dues, assessment, fines and reimbursement of any amounts paid by the Corporation to a Cross Margining Clearing Organization under any Cross Margining Program) at any time it was a Clearing Member and for a period of six months after it ceases being a Clearing Member;

(ii) against any amounts that are charged as provided in or pursuant to Section 5.5 of these By-Laws against the Guaranty Fund deposits of all Clearing Members at any time that such Person was a Clearing Member and for a period of six months thereafter; and

(iii) to provide such funds, on such terms and conditions, as the Board in its discretion, acting by a vote of not less than three-fourths of all directors eligible to vote, may deem necessary or appropriate to

facilitate the transfer of customer accounts from a Clearing Member experiencing financial difficulty to another Clearing Member, if the Board shall determine by such vote that to do so is in the best interests of the Corporation.

(f) The Corporation may at any time and from time to time assign, pledge, repledge or otherwise create a lien on or security interest in, the Guaranty Fund and/or the cash, securities and other property held in the Guaranty Fund to secure the repayment of funds borrowed by the Corporation (plus interest, fees and other amounts payable in connection therewith). Any such borrowing shall be on terms and conditions deemed necessary or advisable by the Corporation (including the collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Clearing Member to the Corporation for which such cash, securities or other property was pledged to or deposited with the Corporation. Any funds so borrowed shall be used and applied by the Corporation solely for the purposes for which cash, securities and other property held in the Guaranty Fund are authorized to be used pursuant to these By-Laws and Rules; provided that the failure of the Corporation to use such funds in accordance with this subsection shall not impair any of the rights or remedies of any assignee, pledgee or holder of any such lien or security interest. Cash, securities and other property held in the Guaranty Fund, subject to the rights and powers of the Corporation with respect thereto as set forth in these By-Laws, the Rules and any agreements between any Clearing Member and the Corporation, and subject to the rights and powers of any person to which the Guaranty Fund or any cash, securities or other property held therein shall have been

assigned, pledged, repledged or otherwise subjected to a lien or security interest, shall remain the property of the respective Clearing Members depositing such cash securities and other property.

(g) Subject to the rights of any assignee, pledgee or holder of a lien or security interest as provided in subsection (f) of this Section 5.4, if at any time the amount of any cash, plus the value of any securities, on deposit in the Guaranty Fund for any Clearing Member

(i) shall exceed the amount required to be on deposit for such Clearing Member by more than such amount as the Board may prescribe, the Corporation will return the excess to such Clearing Member upon its written request.

(ii) shall be less than the amount required to be on deposit for such Clearing Member, such Clearing Member shall restore the deficiency (including, without limitation, a deficiency caused by the application of such Clearing Member's deposits in the Guaranty Fund as described in Section 5.4(e) of these By-Laws) on demand; provided, however, that a Clearing Member that has withdrawn as a Clearing Member shall not be required to restore a deficiency occurring after the effective date of its withdrawal; and, further provided, that if and to the extent that any such deficiency is caused by the application of such Clearing Member's deposits in the Guaranty Fund to meet a Monetary Default pursuant to Section 5.5(b)(iii) of these By-Laws, any amounts deposited with the Corporation to restore such deficiency shall not be applied to further meet the same Monetary Default.

(h) Any interest earned on any securities deposited in the Guaranty Fund by a Clearing Member shall belong

and be credited to such Clearing Member. The Corporation may invest any cash deposited in the Guaranty Fund in securities which are direct obligations of the United States Government and may engage in repurchase transactions with any cash or securities on deposit. Any interest, capital gain or other income earned on any such securities shall belong and be credited to the Corporation.

(i) Subject to the rights of any assignee, pledgee or holder of a lien or security interest as provided in subsection (f) of this Section 5.4, whenever a Person ceases to be a Clearing Member, the Corporation shall return to such Person the amount of cash and securities on deposit in the Guaranty Fund for such Person; provided, however, that the Corporation shall not be required to so return such cash and securities after the effective date of the termination of such Clearing Membership until six months after the last date on which such Person either had any open positions carried by the Corporation or had any futures contracts, options or other contracts or instruments cleared by the Corporation (or such longer period as the Board may prescribe), unless the Corporation receives guaranties or other security satisfactory to it to assure the availability of any amounts to be applied as provided in subsection (e) of this Section 5.4.

(j) If the Guaranty Fund or any part therefore is lost as a result of the insolvency of any bank or other depository, embezzlement, defalcation or any reason other than use pursuant to Section 5.5 of these By-Laws, such loss may, in the discretion of the Board, be restored by application of the following sources of funds in the order listed (each such source to be fully utilized before the next following source is applied):

(i) such portion, if any, of the surplus of the Corporation as the Board determines to be available for such purpose; and

(ii) assessments levied by the Corporation upon the Clearing Members, which assessments shall be paid to the Corporation at such time and in such manner as the Board may specify. The amount of a Clearing Member's assessment shall be in the amount derived by multiplying the loss by a fraction, the numerator of which shall be the amount of such Clearing Member's required deposit in the Guaranty Fund on the day preceding the loss and the denominator of which shall be the total amount required to be in the Guaranty Fund on such day.

(k) In the event that the Corporation accepts a transfer of cash or securities from a guaranty fund of any other clearing organization of which a Clearing Member is or was a member to satisfy in whole or in part the obligations of such Clearing Member to deposit and maintain funds in the Guaranty Fund, the Corporation shall (to the extent of the amount of the cash and the value of the securities so transferred) guaranty payment by such Clearing Member to such clearing organization of any amount, the payment of which would have been secured by such Clearing Member's deposit in the guaranty fund of such other clearing organization. If the Corporation is required to make any payment pursuant to such guaranty as to any Clearing Member, the Corporation may withdraw the amount thereof out of the Guaranty Fund, and such Clearing Member will restore the amount so withdrawn on demand.

(l) In the event that the Guaranty Fund or any part thereof shall have been applied as described in paragraph

(e) of this Section 5.4 or shall have been lost as described in paragraph (j) of this Section 5.4, and the Corporation shall thereafter recover any amount so applied or lost from any Person liable therefor, the amount of such recovery (after deducting any expenses (including without limitation legal fees and expenses incurred in connection therewith) shall be credited to the Guaranty Fund deposits of each Clearing Member in that proportion which the amount required to be on deposit by such Clearing Member bears to the amount required to be on deposit by all Clearing Members as of the date upon which such application took place or such loss was incurred.

(m) Any expense (including without limitation legal fees and expenses) incurred by the Corporation in connection with the deposit by a Clearing Member of assets into the Guaranty Fund, or the return thereof to such Clearing Member, may at the option of the Corporation be charged to such Clearing Member.

Amended by the Board April and May 1999; effective January 2000.

¶ 11,093

**Section 5.5. *Monetary Defaults; Use of Guaranty Fund; Assessments***

If any Clearing Member fails to deposit with, or pay to, the Corporation in full any original margin, variation margin, option premium or other sum (not including any dues, assessments or fines) under or in connection with any Contract, or fails to satisfy any reimbursement obligation to the Corporation in full under or in connection with any Cross Margining Program, when and as required by or pursuant to the rules of the Listing Exchange, the Rules of the Corporation or pursuant to the terms of any Cross Margining Program, such failure shall constitute a "Monetary Default." If and at such times as the Corporation has in effect a procedure whereby deposits or payments of sums with or to the Corporation are effected by having the Corporation instruct the Clearing Members' banks to wire transfer funds from their accounts with such banks directly to the accounts of the Clearing Corporation, a Clearing Member shall be deemed to have failed to deposit or pay any sum when and as required if such Clearing Member's bank fails so to wire transfer funds when and as instructed by the Corporation. In the event that at any time a Monetary Default occurs on the part of any Clearing Member (the "Defaulting Clearing Member"), then:

(a) Such Defaulting Clearing Member's original margin on deposit with the Corporation (in both customer and proprietary accounts), its Guaranty Fund deposits and any of its other assets under the control of the Corporation shall be applied by the Corporation to pay the amount owing (the "Defaulted Obligation") as hereinafter set forth. If and to the extent a Monetary Default relates to a

Contract carried in the customer account of a Defaulting Clearing Member, such margin, Guaranty Fund deposit and other assets (whether held for the proprietary account or the customer account) shall be applied to pay the Defaulted Obligation. If and to the extent a Monetary Default relates to a Contract carried in the proprietary account of a Defaulting Clearing Member, such Guaranty Fund deposit, but only that portion of such margin and such other assets as are held for the proprietary account, shall be applied to pay the Defaulted Obligation. The Defaulting Clearing Member shall immediately restore any deficiencies in its margin and Guaranty Fund deposits resulting from any such application.

(b) If the margin, Guaranty Fund deposit and other assets of a Defaulting Clearing Member under the control of the Corporation are in the aggregate less than the Defaulted Obligation, and if the Defaulting Clearing Member fails to pay the Corporation the amount of the deficiency on demand, such Defaulting Clearing Member shall continue to be liable therefor, but the amount of the deficiency, until collected from the Defaulting Clearing Member, shall be met from the following sources of funds in the order listed (each such source to be fully utilized before the next following source is applied):

(i) such portion, if any, of the surplus of the Corporation as the Board determines to be available for such purpose;

(ii) If the President, with the concurrence of the Chairman or the Vice Chairman, so determines, a loan on such terms and conditions as they may determine to be necessary or appropriate (including without limitation granting an assignment, pledge or other lien on or security interest in the Guaranty

Fund or the cash, securities and other property held in the Guaranty Fund as provided in Section 5.4(f) of these By-Laws);

(iii) subject to Section 5.4(g)(ii) of these By-Laws, the Guaranty Fund;

(iv) insurance proceeds, if any, received by the Corporation in connection with the Monetary Default giving rise to the Defaulted Obligation; and

(v) assessments levied by the Corporation upon the Clearing Member (other than the Defaulting Clearing Member) as hereafter provided in this Section 5.5.

The total amount to be assessed at any one time pursuant to clause (v) of this paragraph (b) is hereinafter called the "Assessment Amount."

(c) The amount of any assessment levied on any Clearing Member shall be computed as follows:

(i) Divide the number of futures contracts, options and other contracts or instruments involving all commodities traded on or subject to the rules of any Exchange which were cleared for such Clearing Member by the Corporation and by any Former Clearing Organization for the period of six months preceding the Monetary Default by the total number of futures contracts, options and other contracts or instruments involving in such commodities cleared by the Corporation and any Former Clearing Organization during such six-month period for all Clearing Members being assessed, and multiply the resultant fraction by 20% of the Assessment Amount.

(ii) Divide the total daily gross open interest in futures contracts, options and other contracts or instruments involving such commodities carried by

the Corporation and any Former Clearing Organization during such six-month period for such Clearing Member by the total daily gross open interest in futures contracts, options, and other contracts or instruments carried by the Corporation and any Former Clearing Organization during such six-month period for all Clearing Members being assessed, and multiply the resultant fraction by 80% of the Assessment Amount.

(iii) For each Clearing Member, add the amounts computed pursuant to subparagraphs (i) and (ii). The total shall constitute the amount of the assessment to be levied on such Clearing Member pursuant to this paragraph (c).

(d) If the amount assessed against any Clearing Member as determined pursuant to paragraph (c) of this Section 5.5 would exceed the maximum set forth in paragraph (c) of this Section 5.5, or if the amount assessed against any Clearing Member shall exceed the amount paid by such Clearing Member, the excess shall be assessed against the other Clearing Members (other than the Defaulting Clearing Member and any Clearing Member that shall have been assessed the maximum permitted by paragraph (e)) in accordance with such subparagraph (c), as if the excess were the Assessment Amount. Assessments pursuant to this paragraph (d) shall be repeated until the entire Assessment Amount shall have been assessed.

(e) If a Person shall withdraw as a Clearing Member, and if on the Withdrawal Date no assessment shall have been imposed upon such Clearing Member within the period of ten Business Days preceding the Withdrawal Date, or if on the Withdrawal Date an assessment shall have been so imposed during such period and such

assessment shall have been paid in full (subject to the Assessment Cap), then the total amount that may be assessed against such Clearing Member pursuant to this Section 5.5 on and after the first day of such period shall not exceed an amount (the "Assessment Cap") which is the lesser of:

(i) 25% of such Clearing Member's Capital; or

(ii) $10 million.

Amounts deposited by Clearing Members in the Guaranty Fund, including without limitation amounts deposited to restore a deficiency as provided in Section 5.4(g)(ii) do not constitute assessments imposed or paid and are not subject to the Assessment Cap.

(f) If in any case, because of the limitations contained in paragraph (e) of this Section 5.5, the maximum permitted assessments are less than the Assessment Amount, the Board shall determine what if any further action to take, provided that under no circumstances may the Board levy assessments on any Clearing Member that would exceed the limitations contained in paragraph (e) of this Section 5.5.

(g) Notwithstanding any other provision of these By-Laws, a Person which withdraws as a Clearing Member shall be subject only to assessments imposed to meet:

(i) Monetary Defaults occurring prior to the date on which such Clearing Member's withdrawal becomes effective or such Person otherwise ceases to be a Clearing Member (the "Withdrawal Date"), subject to the limitations contained in paragraph (e) of this Section 5.5;

(ii) assessments levied under Section 5.4(j) of these By-Laws prior to the effective date of such Clearing Member's withdrawal; and

(iii) the first Monetary Default occurring after the Withdrawal Date, subject to the limitations contained in paragraph (e) of this Section 5.5.

(h) All assessments shall be due and payable within such time as the Corporation may prescribe. If any Person shall not pay any assessment when due, such Person shall continue to be liable therefor, but the Corporation may assess the Clearing Members (other than such Person, the Defaulting Clearing Member and any Clearing Member that shall have been assessed the maximum amount permitted by paragraph (e)) for the unpaid amount in accordance with paragraphs (c) and (d) of this Section 5.5.

(i) If, after making any assessments to meet any Defaulted Obligation owing by a Defaulting Clearing Member as referred to in paragraph (b), or to meet any assessment not paid as referred to in paragraph (h), the Corporation collects the amount of such Defaulted Obligation or such unpaid assessment in whole or in part from the Person or Persons liable therefor, the Corporation shall refund the amount so collected (net of any expenses, including without limitation any legal fees incurred in connection therewith) pro rata to the Clearing Members that had been assessed to meet such Defaulted Obligation or nonpayment and had paid the amount so assessed.

Amended by the Board April and May 1999; effective January 2000.

¶ 11,095

**Section 5.6.** ***Position Limits***

(a) The Board shall establish a Position Limit on the total Net Interest and the total Offset Interest that each Clearing Member may have open with the Corporation at any one time, subject to the following:

(i) The Position Limit established for each Clearing Member shall be based on the Board's evaluation of the financial and operational capacity of such Clearing Member and such other factors as the Board, in its discretion considers appropriate, including, but not limited to, (A) the Capital, business needs and financial condition of the Clearing Member; (B) the number of memberships on other clearing organizations held by the Clearing Member; (C) the average number of contracts cleared by the Clearing Member through each clearing organization each day and each month during the preceding twelve months and the extent to which such contracts were cleared for either customer accounts, proprietary accounts, or both; (D) the length of time the Clearing Member has been a Clearing Member and/or a clearing member of any Former Clearing Organization; and (E) the number of guarantees given by such Clearing Member of the obligations of any member of any futures or options exchange in the United States.

(ii) A Clearing Member may not have a Position Limit in excess of the maximum set forth below for the amount of such Clearing Member's Capital:

| *Capital* | *Maximum Net Interest and Offset Interest* |
|---|---|
| $250,000,001 and over | 100,000 |
| 150,000,001 – 250,000,000 | 80,000 |
| 100,000,001 – 150,000,000 | 65,000 |
| 75,000,001 – 100,000,000 | 50,000 |
| 50,000,001 – 75,000,000 | 40,000 |
| 40,000,001 – 50,000,000 | 32,000 |
| 30,000,001 – 40,000,000 | 28,000 |
| 20,000,001 – 30,000,000 | 24,000 |
| 15,000,001 – 20,000,000 | 20,000 |
| 10,000,001 – 15,000,000 | 16,500 |
| 9,000,001 – 10,000,000 | 13,000 |
| 8,000,001 – 9,000,000 | 12,000 |
| 7,000,001 – 8,000,000 | 10,500 |
| 6,000,001 – 7,000,000 | 9,500 |
| 5,000,001 – 6,000,000 | 8,500 |
| 4,000,001 – 5,000,000 | 7,000 |
| 3,000,001 – 4,000,000 | 5,500 |
| 2,500,001 – 3,000,000 | 4,000 |
| 2,000,000 – 2,500,000 | 3,000 |

For purposes of this paragraph, the Board may in its discretion treat the Capital of a Clearing Member (A) as unconditional, irrevocable letter of credit deposited with the Corporation, payable to the order of the Corporation, in a form and from a bank acceptable to the Corporation; (B) a pledge of cash, securities or other assets that is or are not the property of such Clearing Member, in a form acceptable to the Corporation; and/or (C) an unconditional guarantee in favor of the Corporation, in a form and from a guarantor acceptable to the Corporation provided that such a guarantee shall be accepted only (i) from a Clearing Member which had a similar guarantee on deposit with a Former Clearing

Organization immediately prior to the Operational Date, (ii) in an amount not exceeding the amount of such similar guarantee, and (iii) for a period expiring one year after the Operational Date. The use of such letters of credit, pledges and guarantees shall be subject to such limitations as the Corporation, in its discretion, may establish in any particular case. The amount of any letter of credit deposited by a Clearing Member pursuant to Clause (A) may not exceed the amount of such Clearing Member's Capital, except that any Clearing Member which immediately prior to the Operational Date was a clearing member of CCC or CFCCNY and had a letter of credit on deposit with CCC or CFCCNY in an amount exceeding such Clearing Member's Capital may, for a period of one year following the Operational Date, have on deposit with the Corporation a letter of credit in an amount not exceeding the amount of the letter of credit which had been on deposit with CCC or CFCCNY, regardless of the amount of such Clearing Member's Capital.

(iii) Any Clearing Member whose Position Limit is set at a level less than the maximum Net Interest or Offset Interest set forth in subparagraph (ii) of this paragraph (c) may file a written request with the Corporation for an increase in such Position Limit. The Board, with or without a hearing as it may consider proper, shall take such action thereon as it may deem appropriate.

(iv) Except as provided in paragraph (c) of this Section 5.6, no Clearing Member may have a Position Limit in excess of 100,000 Contracts, regardless of its Capital.

(v) Any Clearing Member may elect to have its Position Limit established on the basis of an amount

of Capital designated by it which is less than its actual Capital by giving written notice of such designation to the Corporation.

(b) Notwithstanding the provisions of subparagraph (i) of paragraph (a) of this Section 5.6, any Clearing Member which was a clearing member of CCC, CFCCNY or both immediately prior to the Operational Date shall initially have a Position Limit which is the sum of its position limits on CCC and CFCCNY immediately prior to the Operational Date, subject to being changed as provided in paragraph (e) of this Section 5.6.

(c) No Clearing Member may have with the Corporation a total Net Interest or a Total Offset Interest in excess of such Clearing Member's Position Limit, except that notwithstanding subparagraphs (ii) and (iv) of paragraph (a) of this Section 5.6) a Clearing Member may exceed its Position Limit up to, but not in excess of, 50 percent of such Position Limit, provided that such Clearing Member deposits with the Corporation (in addition to all other deposits and payments for margins, fees and other charges which may be required) original margin as follows:

(i) For Contracts which exceed such Position Limit by not more than 25 percent of such Position Limit, an amount equal to 50 percent of the maximum amount of margin required for any Contract (including any surcharge based on position size), as prescribed by the Corporation from time to time; and

(ii) For Contracts which exceed such Position Limit by more than 25 percent but not more than 50 percent of such Position Limits, an amount equal to 100 percent of the maximum amount of margin

required for any Contract (including any surcharge based on position size), as prescribed by the Corporation from time to time.

Any funds so deposited by any Clearing Member shall be deposited for the proprietary account, and not the customer account, of such Clearing Member.

(d) Any Clearing Member whose Net Interest or Offset Interest exceeds the Position Limit imposed on such Clearing Member pursuant to Section 5.6 of the By-Laws by more than the amount permitted by paragraph (c) thereof shall transfer and/or liquidate such number of Contracts as may be necessary to eliminate the excess within such time as the Corporation may prescribe and shall report to the Corporation when such transfers and/or liquidations have been completed. If a Clearing Member fails so to transfer and/or liquidate Contracts within the time prescribed by the Corporation, the Corporation may liquidate such Contracts as the Corporation deems necessary on behalf of such Clearing Member in accordance with Rule 803. The Corporation in its discretion may require any Clearing Member whose Net Interest or Offset Interest exceeds its Position Limit by more than the amount permitted by paragraph (c) thereof to deposit with the Corporation, in such form and by such time as it shall specify, such additional original margin as the Corporation determines is necessary with respect to the excess until such excess has been eliminated. Any instance of a Clearing Member exceeding a Position Limit by more than the amount permitted by paragraph (c) thereof is a violation of the Rules which subjects a Clearing Member to possible disciplinary action under the Rules.

(e) For purposes of this Section 5.6:

(i) The term "Contracts" shall include options converted to futures contract equivalents in accordance with such procedures as the Corporation may adopt from time to time; and

(ii) The Net Interest and Offset Interest of each Clearing Member shall be calculated in accordance with such formulas and procedures as the Corporation may adopt from time to time.

(f) The Board or the President may at any time reduce the Position Limits of any Clearing Member if in the judgment of the Board or the President such reduction is necessary for the protection of the Corporation. After receiving notice of any such reduction in its Position Limit, a Clearing Member shall transfer and/or liquidate any Contracts in excess of the reduced Position Limit within such time as the Board or the President may prescribe. Any such action by the President will be subject to revocation or modification by the Board, and the Board will review any such action taken by the President not later than its next regularly scheduled meeting.

(g) Where any two or more Clearing Members are Affiliated Persons, the Board may impose limits on the size of the positions that such Clearing Members may in the aggregate carry with the Corporation.

**¶ 11,097**

**Section 5.7. *Original Margin***

(a) Each Clearing Member shall deposit with the Corporation original margin in respect of all Contracts carried by the Corporation for such Clearing Member

(customer and proprietary) in such amounts, in such forms, and by such times as the Corporation may require from time to time.

(b) Margin shall be collected by the Corporation in accordance with the methods and procedures specified in or pursuant to the Rules.

(c) The Corporation may establish Cross Mrgining [sic] Programs with one or more Cross Margining Clearing Organizations permitting Clearing Members to subject eligible positions to cross-margining treatment. Each such Cross Margining Program shall be conducted in accordance with a cross margin agreement between the Corporation and one or more Cross Margining Clearing Organizations.

Amended by the Board April and May 1999; effective January 2000.

## ARTICLE VI

## Indemnification; Liability

**¶ 11,101**

**Section 6.1.** ***Indemnification by Corporation***

(a) Except to the extent specifically prohibited by the BCL, the Corporation shall promptly indemnify each person who is or at any time was a director or officer of the Corporation, whether or not then in office, who is made or is threatened to be made a party to any action or proceeding, threatened or pending, and whether civil, criminal or administrative and whether or not brought by or in the right of the Corporation, or who is the subject of an investigation by any governmental agency,

Self-Regulatory Organization (other than the Corporation), securities exchange, securities clearing organization, registered securities association or other self-regulatory body, by reason of the fact that such person is or was a director or officer of the Corporation, or serves or served any other corporation, or Entity in any capacity at the request of the Corporation, against judgments, fines, amounts paid in settlement and expenses (including reasonable attorneys' fees), actually and necessarily incurred in connection with such action or proceeding, or any appeal therein, or any such investigation.

(b) The Corporation shall advance or promptly reimburse upon request of a person referred to in subsection (a) of this Section 6.1 all expenses, including reasonable attorneys' fees, actually and necessarily incurred by such person in connection with any action, proceeding or investigation of the kind referred to in said paragraph (a) in advance of the final disposition thereof, subject to receipt of a written undertaking by or on behalf of such person to repay such amounts if such person is ultimately found not to be entitled to indemnification under this Article or otherwise or, where indemnification is granted, to the extent the expenses so advanced or reimbursed exceed the amount to which such person is entitled, provided that such person shall cooperate in good faith with any request of the Corporation that common counsel be used by parties to any action, proceeding or investigation who are similarly situated unless to do so would be inappropriate because of actual or potential differing interests between such parties.

(c) A person for whom indemnification or the advancement or reimbursement of expenses is provided for under this Section 6.1 may elect to have the provisions of

this ARTICLE VI interpreted on the basis of the applicable statute in effect (i) at the time of the occurrence of the event or events giving rise to the action, proceeding or investigation, to the extent permitted by statute, or (ii) at the time indemnification or advancement or reimbursement of expenses is provided or sought.

(d) The indemnification provided by this Section shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled as a matter of law.

(e) Indemnification under the provisions of this Section shall not be available to a director or officer in the event that a judgment or other final adjudication adverse to the director or officer establishes that his or her acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the matter so adjudicated, or that he or she personally gained in fact a financial profit or other advantage to which he or she was not legally entitled.

(f) Indemnification shall be accorded by the Corporation and related expenses shall be advanced to members of any committee authorized by the By-Laws or Rules of the Corporation or established by the Board, and to employees of the Corporation, to the same extent as is provided to directors and officers of the Corporation. The foregoing right of indemnification shall not affect any rights to indemnification to which the persons described in this subsection (f) may be entitled by contract or otherwise under law.

¶ 11,103

**Section 6.2.** ***Indemnification by Resolution or Agreement.***

The Corporation, by a resolution of the Board or an agreement approved by the Board, may, to the fullest extent permitted by applicable statute, indemnify and advance or reimburse expenses to any person, including a person entitled to indemnification pursuant to Section 6.1, but nothing herein shall limit or affect the rights of any such person under that Section.

¶ 11,105

**Section 6.3.** ***Enforcement***

(a) The right to be indemnified or to the advancement or reimbursement of expenses pursuant to Section 6.1 or a resolution or agreement authorized pursuant to Section 6.2(i) is a contract right pursuant to which the person entitled thereto may bring suit as if the provisions hereof or of any such resolution were set forth in a separate written contract between the Corporation and such person, and (ii) shall continue to exist after any rescission or restrictive modification hereof or of any such resolution or agreement with respect to events occurring prior thereto.

(b) If a request to be indemnified or for the advancement or reimbursement of expenses pursuant to Section 6.1 or a resolution or agreement authorized by Section 6.2 is not paid in full by the Corporation within thirty days after a written claim has been received by an officer of the Corporation therefore and the claimant thereafter brings suit against the Corporation to recover

the unpaid amount of the claim which is successful in whole or in part, the Corporation shall be obliged to pay the claimant the expenses, including reasonable attorneys' fees, of actually prosecuting such claim.

¶ 11,107

**Section 6.4.** ***Indemnification By Clearing Members***

(a) If any action or proceeding is brought or threatened against the Corporation or any person entitled to be indemnified by the Corporation pursuant to Section 6.1 or Section 6.2 (such persons being collectively referred to as "Officials"), claiming, directly or indirectly, in whole or in part, that the Corporation or such Official has failed, neglected or omitted to prevent, detect or require any conduct by a Clearing Member or by an Affiliated Person of a Clearing Member, which conduct or lack thereof is alleged to constitute a violation of the Commodity Exchange Act, any other federal or state law, any Commission Regulation, any rule of any Self-Regulatory Organization, or any By-Law or Rule, such Clearing Member shall indemnify and hold harmless the Corporation and each such Official from and against all loss, liability, damage and expense (including but not limited to attorneys' fees, expenses of investigating such claim, judgments and amounts paid in settlement) incurred by or asserted against the Corporation or any such Official in or in connection with any such legal proceeding.

(b) If any such action or proceeding is brought against the Corporation or an Official which could result in indemnification by a Clearing Member pursuant to subsection (a) of this Section 6.4:

(i) Such party shall promptly give such Clearing Member notice thereof in writing.

(ii) Neither the Corporation nor any such Official may settle a claim to the extent it seeks the recovery of money damages without the prior consent of such Clearing Member; provided that if such Clearing Member does not consent to any proposed settlement within ten (10) days following the date it receives written notice of the terms of such settlement, the Corporation or such Official may require such Clearing Member to post such security for the payment of indemnification obligations to the Corporation or such Official as the Corporation or such Official deems necessary, but not in excess of the money damages claimed plus interest and anticipated expenses.

¶ 11,109

**Section 6.5.** ***Exculpation and Reimbursement of Corporation***

(a) NEITHER THE CORPORATION, NYBT NOR ANY EXCHANGE, NOR ANY DIRECTOR, COMMITTEE MEMBER, OFFICER, AGENT OR EMPLOYEE OF THE CORPORATION, NYBT OR ANY EXCHANGE, SHALL BE LIABLE TO ANY CLEARING MEMBER FOR ANY DAMAGES ARISING OUT OF OR IN CONNECTION WITH ANY ERROR, ACT OR OMISSION ON THE PART OF THE CORPORATION, OR ON THE PART OF ANY PERSON IN THE CAPACITY OF MEMBER OR IN THE CAPACITY OF DIRECTOR, COMMITTEE MEMBER, OFFICER, AGENT OR EMPLOYEE OF A MEMBER OR OF THE CORPORATION, WHETHER OR NOT SUCH DAMAGES ARE DUE TO NEGLIGENCE, UNLESS SUCH ERROR, ACT OR OMISSION WAS THE RESULT

OF WILLFUL OR WANTON CONDUCT OR WAS IN BAD FAITH.

(b) Any Clearing Member which institutes an action or proceeding against the Corporation, or any of the officers, directors, committee members, agents or employees of the corporation, and which fails to prevail in such action or proceeding, shall reimburse the Corporation and such officer, director, committee member, agent or employee for any and all costs or expenses (including but not limited to attorneys' fees, expenses of investigation and amounts paid by way of indemnifying any officers, directors, employees or other persons by the Corporation) incurred in connection with the defense of such action or proceeding.

¶ 11,111

**Section 6.6.** ***General***

(a) The indemnification and advancement or reimbursement of expenses granted pursuant to the provisions of Section 6.1 and 6.2 shall be in addition to and shall not be exclusive of any other rights to indemnification and advancement or reimbursement of expenses to which any person may otherwise be entitled by statute, the Certificate of Incorporation, insurance policy, contract or otherwise.

(b) For purposes of this Article VI, the terms: (i) "the Corporation" shall include any legal successor to the Corporation, including any corporation or other entity which acquires all or substantially all of the assets of the Corporation in one or more transactions; and (ii) "person" shall include the personal representative of an individual

described in this ARTICLE VI who is deceased or under a disability.

## ARTICLE VII

## Emergency Powers

¶ 11,113

### Section 7.1. *Exchange-Determined Emergency*

If any Exchange determines that there is an Emergency, the Corporation shall take such action as may be ordered by, or as may be necessary or appropriate to implement emergency action ordered by, that Exchange with respect to (a) Contracts traded on or subject to the rules of that Exchange and cleared by the Corporation, and (b) Clearing Members of that Exchange.

¶ 11,115

### Section 7.2. *Corporation-Determined Emergency*

If the Board, by a three-fourths vote of the members of the Board present and voting at any meeting, determines that there is an Emergency, it may place into immediate effect a rule which may provide for, or may authorize the Corporation to undertake, actions necessary or appropriate to meet the Emergency.

¶ 11,117

### Section 7.3. *Inconsistent Determinations*

In the event of an inconsistency between a determination made by an Exchange as referred to in Section 7.1 and a determination made by the Corporation

pursuant to Section 7.2, the determination so made by the Exchange shall govern.

**¶ 11,119**

**Section 7.4. *Physical Emergency***

If, in the judgment of the persons specified below, the physical functioning of the Corporation is, or is threatened to be, severely and adversely affected by a Physical Emergency, such persons are authorized to take such action as they deem necessary or appropriate to deal with such Physical Emergency. The persons authorized to take action pursuant to this Section 7.4 are any one of the following, in the order of their availability to take such action: (a) the Chairman; (b) any Vice Chairman; (c) the President; (d) any Vice President; and (e) any other officer of the Corporation.

**¶ 11,121**

**Section 7.5. *Definitions***

For purposes of this ARTICLE VII of the By-Laws, the following terms shall have the following meaning:

(a) The term "Emergency" means any occurrence or circumstance which an Exchange determines constitutes an emergency or physical emergency in accordance with the by-laws or rules of that Exchange, or which the Board, pursuant to Section 7.2, determines requires immediate action and threatens or may threaten such things as the orderly matching, clearing or liquidation of, or delivery or exercise pursuant to, any Contract, including such matters as:

(i) Any Physical Emergency.

(ii) The bankruptcy or insolvency of any Clearing Member, or the initiation of any proceedings for the liquidation of any Clearing Member, or the imposition of any injunction or other restraint by any government agency, court or arbitrator upon a Clearing Member which may affect the ability of that Clearing Member to perform its obligations under the By-Laws or the Rules.

(iii) Any circumstance in which it appears that a Clearing Member or any other person has failed to perform Contracts, is insolvent, or is in such financial or operational condition or is conducting business in such a manner that such person cannot be permitted to continue in business without jeopardizing the safety of customers' funds, of other Clearing Members, or of the Corporation.

(iv) Any circumstance or event which suddenly curtails the operations of one or more banks involved in the margining of Contracts; and

(v) Any other unusual, unforeseeable and adverse circumstance with respect to which it is impracticable for the Corporation to submit, in a timely fashion, a reviewable rule to the Commission for prior approval.

(b) The term "Physical Emergency" means any circumstance which may have a severe, adverse effect upon the physical functions of the Corporation including, but not limited to, fire or other casualty, bomb threats, substantial inclement weather, power failures, communication breakdowns, transportation breakdowns and computer malfunctions.

## ARTICLE VIII

## Miscellaneous

¶ 11,123

### Section 8.1. *Fiscal Year*

The fiscal year of the Corporation shall be fixed by resolution of the Board.

¶ 11,125

### Section 8.2. *Seal*

The seal of the Corporation shall be circular in form and have inscribed thereon the name of the Corporation, the year of its organization, and the words "Corporate Seal" and "New York". If and when so directed by the Board or the President, a duplicate of the seal may be kept and used by the Corporation. The seal may be used by causing it or a facsimile thereof to be affixed or impressed or reproduced in any other manner.

¶ 11,127

### Section 8.3. *Obligations*

All contracts, checks, notes and other evidences of indebtedness of the Corporation, and all other instruments and documents delivered on behalf of the Corporation, shall be signed by such officers of the Corporation or by such other person or persons as may be authorized by the Board.

¶ 11,129

**Section 8.4.** ***Amendment and Repeal***

These By-Laws may be amended or repealed, and any other By-Laws may be adopted, amended or repealed, by a majority of the votes of the shares at the time entitled to vote in the election of any directors. These By-Laws may also be amended or repealed, and any other By-Laws may be adopted, amended or repealed, by the Board by a vote of not less than two-thirds of all the members of the Board, but any By-Law adopted by the Board may be amended or repealed by the shareholders entitled to vote thereon.

## RULES OF COMMODITY CLEARING CORPORATION
## PART 1
### General Provisions

¶ 11,151

**Rule 101.** ***Definitions***

Unless the context otherwise clearly requires, all terms defined in the By-Laws shall have the same meanings when used in these Rules, and in addition the following terms shall have the following meanings when used in these Rules:

The term "Act" means the Commodity Exchange Act, as in effect from time to time.

The term "Approved Financial Institution" means a bank, trust company or other institution designated as such by the Board pursuant to Rule 501.

The term "Approved Foreign Currency" means any currency other than the U.S. dollar which is deliverable under any Contract or which is approved

by the Board for any purpose under the By-Laws or these Rules.

The term "Arbitrage Bank" shall have the meaning set forth in Rule 210.

The term "Bank Holiday" means any day when banks in the State of New York generally are closed, as determined by the Corporation.

The term "By-Laws" means the by-laws of the Corporation, and the interpretations, resolutions, orders and directives of the Board thereunder, as in effect from time to time.

The term "Class B Members" means Clearing Members described in and subject to the provisions of Rule 210.

The term "customer" has the meaning set forth in Commission Regulation 1.3, as in effect from time to time.

The term "Designated Enforcement Staff" means the enforcement staff of the Exchange to which the Corporation has referred the investigation or settlement of, or the prosecution of disciplinary proceedings in connection with, any potential violation of the By-Laws and Rules, pursuant to Part 9 of the Rules.

The term "Exchange member" means a member of, and any person enjoying membership privileges on, an Exchange.

The terms "Exchange rules," "rules of the Listing Exchange" and "rules of an Exchange" mean the certificate of incorporation, by-laws, rules, regulations, resolutions, orders, directives and procedures of such

Exchange, and any interpretations thereof duly adopted by such Exchange, as in effect from time to time.

The term "Financial Emergency" means, with respect to any Clearing Member, any situation in which the financial or operational condition of such Clearing Member is not adequate for such Clearing Member to meet its obligations (including without limitation its obligations to comply with the By-Laws or these Rules) or to engage in business, or is such that it would not be in the best interests of the Corporation or the marketplace for such Clearing Member to continue in business.

The term "Government" means a security which is a direct obligation of the United States government.

The term "Order for Relief" means the filing of a petition in bankruptcy in a voluntary case and the adjudication of bankruptcy in an involuntary case.

The term "Settlement Price" shall mean the settlement price for any Contract as determined in accordance with the rules of the Listing Exchange of such Contract.

**¶ 11,153**

**Rule 102. *Extension or Waiver of Rules***

(a) The time fixed by the Rules for the doing of any act or acts may be extended, or the doing of any act or acts required by the Rules may be waived, by the Board whenever, in its judgment, such extension or waiver is necessary or in the best interests of the Corporation.

(b) The time fixed by the Rules for filing any report of other document, for submitting any information or for

making deposits or payments of original margin, variation margin or premiums may be extended by the President whenever, in his judgment, such extension is necessary or in the best interests of the Corporation. A written report of any such extension, stating the pertinent facts an the reason such extension was deemed necessary or expedient, shall be presented to the Board at its next regular meeting. Any such extension may continue in effect after the event or events giving rise thereto; provided, however, that the time fixed for making deposits or payments of original margin, variation margin or premiums shall not be extended beyond two hours after the time such deposit or payment is due, and no other extension shall continue in effect for more than sixty calendar days, unless it is approved by the Board within such period.

¶ 11,155

**Rule 103. *Action by the Corporation***

Except as otherwise specifically provided in the By-Laws or Rules, any action permitted or required by the By-Laws or Rules to be taken by the Corporation may be taken by the Board, the Chairman, the President or any other officer to whom authority has been delegated by the Board, the Chairman or the President.

¶ 11,157

**Rule 104. *Headings***

The headings of the various Rules appear for convenience only and shall not affect the meaning of the language contained in the Rules.

¶ 11,159

**Rule 105. *Confidential Treatment of Information Submitted by Clearing Member***

All information received by the Corporation concerning past or current positions carried by the Corporation or any other clearing organization for a Clearing Member, or concerning margin payments between the Corporation or any other clearing organization and a Clearing Member, or concerning deliveries made by or to a Clearing Member, and any financial statements filed with the Corporation by any Clearing Member, shall be held in confidence by the Corporation and shall not be made known to any other person except as follows:

(a) With the written consent of the Clearing Member involved;

(b) To the Commission or the United States Department of Justice pursuant to the requirements of the Act or any Commission Regulation;

(c) Pursuant to a subpoena issued by or on behalf of any person, or in the Corporation's discretion, pursuant to a written request from the Congress of the United States, any committee or subcommittee thereof, the General Accounting Office, or any department or agency of the United States, the State of New York or the City of New York;

(d) Pursuant to an order issued by a court having jurisdiction over the Corporation;

(e) To an Exchange of which such Clearing Member is a member for audit, compliance or market surveillance purposes; provided that the information so furnished to any Exchange shall be limited to

positions, margin payments and deliveries relating to Contracts on that Exchange; and provided further that the furnishing of any such information shall be subject to such terms and conditions as the Board, from time to time, may deem appropriate;

(f) To any person in the business of providing data processing or similar services for the purpose of performing computations or analysis, or of preparing reports or records, for the Corporation, subject to such terms and conditions as the Board, from time to time, may deem appropriate;

(g) To counsel for the Corporation; or

(h) To any other person if, to the extent and pursuant to such terms and conditions as the Board, from time to time, may deem appropriate.

If information concerning one or more named Clearing Members is requested pursuant to paragraphs (b), (c) or (d) above, the Corporation shall so notify each such Clearing Members prior to furnishing such information, unless in the judgment of the Corporation it would be contrary to the best interests of the Corporation to do so.

The Corporation may, to the extent permitted by law, require reimbursement from the person seeking such information for any out-of-pocket expenses incurred by the Corporation (including, but not limited to, compensation or Corporation personnel) in obtaining and making available information pursuant to this Rule 105.

¶ 11,161

**Rule 106. *Employee Disclosures***

No employee of the Corporation may disclose to any other person any material non-public information obtained as a result of employment by the Corporation; provided, however, that this Rule 106 shall not prohibit disclosures made by such an employee:

(i) in the course of such employee's duties, or

(ii) as permitted under Rule 105.

¶ 11,163

**Rule 107. *Trading Prohibition***

(a) An employee of the Corporation shall not trade, directly or indirectly, any commodity interest cleared by the Corporation or any related commodity interest, or any commodity interest cleared by any other commodities clearing organization where the employee of the Corporation has access to material non-public information concerning such commodity interest.

(b) The President (or, in the case of the President, the Board) may grant exemptions from the provisions of Rule 107(a) to employees on a case-by-case basis under circumstances which are not contrary to the purposes of this Rule, the Act, Commission Regulation 1.59, the public interest, or just and equitable principles of trade. Such circumstances may include, but are not necessarily limited to:

(i) Participation in pooled investment vehicles where the employee of the Corporation has no direct

or indirect control over Transactions executed by the pool;

(ii) Service as an executor or administrator of an estate;

(iii) Service in any other fiduciary capacity, such as an officer of a charitable organization, in which the employee receives no pecuniary benefit from the trading of commodity interests;

(iv) Trading in commodity interests cleared by any other commodities clearing organization under circumstances in which the employee's access to material non-public information as to those commodity interests is sufficiently minimal or attenuated so as to be insignificant; and

(v) Such other circumstances as the President (or, in the case of the President, the Board) may determine.

Participation in a Corporation-sponsored savings or retirement plan shall not be deemed to constitute trading directly or indirectly in a commodity interest, notwithstanding such plan's use of pooled funds which utilize commodity interests or the trading thereof.

(c) Any employee exempted under Rule 107(b) must:

(i) Furnish to the Corporation at the President's request (or, in the case of the President, to the Board at its request) account statements and other documents relevant to the trading activities that are so exempted; and

(ii) Inform the President (or, in the case of the President, the Board), within one Business Day of any material change of information that may affect the employee's qualification for such exemption.

(d) Terms used in this Rule 107 shall have the meanings set forth in Commission Regulation 1.59(a).

(e) If the President (or, in the case of the President, the Board), in his (or its) sole discretion, finds that any employee has committed a violation of this Rule 107, such employee shall be subject to such sanctions, including but not limited to demotion, suspension or discharge, as the President (or, in the case of the President, the Board), in his (or its) sole discretion, deems appropriate.

¶ 11,165

**Rule 108.** ***Improper Use or Disclosure of Material, Non-Public Information by Board Member or Committee Member***

(a) No member of the Board or any committee established by the Corporation shall use or disclose, for any purpose other than the performance of such person's official duties as a member of the Board or such committee, any material non-public information obtained by such person as a result of such person's participation on the Board or on any such committee; provided, however, that if any such person who effects any transactions after having received any such material, non-public information so obtained can show that such transaction was effected in the ordinary course of such person's business, such person shall not be deemed to have used such information in violation of this Rule 108(a), unless it can be shown that such person would not have effected such transaction in the absence of such information.

(b) For the purposes of this Rule 108, the terms "material" and "non-public information" each shall have the meaning set forth in Commission Regulation 1.59(a).

¶ 11,167

**Rule 109.** ***Consent to Disclosure of Certain Information***

A person, by becoming a member of the Board or a member of a committee established by the Board, shall be deemed irrevocably to authorize and direct each futures commission merchant at which such person maintains an account to furnish the Corporation with such documents and information relating to such person's trading in futures contracts, securities or options as the Corporation may from time to time request for the purpose of monitoring compliance with Rule 108, and to agree to furnish the Corporation with such information relating to any such trading as the Corporation may from time to time request.

¶ 11,169

**Rule 110.** ***Notices to Clearing Members***

The delivery by hand, electronic transmission, telefacsimile or telephone of any notice, order or other communication to a Clearing Member at the address, telefacsimile number or telephone number last designated by it, or to the locked box of such Clearing Member provided for under Rule 206, shall be good and sufficient delivery thereof to such Clearing Member.

## PART 2

## Clearing Membership

¶ 11,171

**Rule 201.** ***Obligations of Clearing Members***

A Clearing Member shall:

(a) At all times maintain an office to which all notices, orders and other communications from the Corporation may be transmitted or delivered. Such office shall be:

(i) at a location satisfactory to the Board,

(ii) kept open during normal business hours,

(iii) staffed on a full time basis by a general partner or officer of such Clearing Member who has been authorized and empowered by the Clearing Member to take any and all action with respect to such Clearing Member's positions with the Corporation, including but not limited to satisfying margin calls, paying option premiums, issuing and receiving delivery notices and furnishing reports and information, and

(iv) under the direct supervision and responsibility of an executive officer of such Clearing Member, who need not be physically located at such office.

(b) File with the Corporation such information regarding its shareholders, partners, members, officers, directors, management personnel and Affiliated Persons as the Corporation may require.

(c) Furnish the Corporation with such other information regarding the ownership, Control or

management of such Clearing Member as the Corporation may request.

(d) Notify the Corporation in writing prior to any change of Control in the Clearing Member, and not effectuate any change of Control without the prior approval of the Corporation.

(e) Notify the Corporation promptly in writing of any change other than a change of Control which would cause a statement furnished pursuant to paragraphs (b) and (c) of this Rule 201 to be inaccurate or incomplete.

(f) Establish and maintain accounts at an Approved Financial Institution for the deposit of funds (including without limitation Approved Foreign Currencies) and securities required to be transmitted to and from such Clearing Member pursuant to the By-Laws and these Rules, and to enter into arrangements with such Approved Financial Institution satisfactory to the Corporation for the transfer by wire or other means of funds and securities into and out of such accounts (separately for customer and proprietary accounts) on the order of the Corporation.

(g) Maintain such operational capability, including without limitation having such equipment, facilities and personnel, as in the judgment of the Corporation are necessary and desirable in order properly to perform the function of clearing Contracts with the Corporation and to comply with all of the obligations of the Clearing Member pursuant to the By-Laws and these Rules.

(h) Timely comply with all provisions of any agreements entered into by such Clearing Member with the Corporation.

(i) Otherwise timely comply with all provisions of the By-Laws and these Rules.

(j) Timely comply with all provisions of any Cross Margining Program.

Amended by the Board April and May 1999; effective January 2000.

¶ 11,173

**Rule 202. *Reports to Clearing Members***

Each Clearing Member shall immediately (a) review every communication delivered to such Clearing Member by the Corporation and (b) report to the Corporation any error in such communication.

¶ 11,175

**Rule 203. *Effectiveness of Termination of Authority***

Any power of attorney or other authorization to transact business with the Corporation given by a Clearing Member to any person shall remain in effect until a written notice of change pursuant to Rule 201(d) has been received by the Corporation.

¶ 11,177

**Rule 204. *Receipt of Documents***

(a) The Corporation shall assign a locked box at the office of the Corporation (or of a designated agent of the Corporation) to each Clearing Member for the distribution

of forms, papers, documents, notice, statements and other such items as the Corporation deems appropriate.

(b) Every Clearing Member shall send an authorized representative to the office of the Corporation for receipt of any documents delivered pursuant to the Rules and of all items placed in the locked box of the Clearing Member at such intervals as may be necessary for the Clearing Member to perform all its obligations under the Rules, but not less frequently than once each Business Day.

(c) THE CORPORATION SHALL HAVE NO RESPONSIBILITY FOR THE FORM OR CONTENT OF ANY TICKET, CHECK, PAPER, DOCUMENT OR OTHER MATERIAL (OTHER THAN ANY SUCH MATERIAL PREPARED BY IT) PLACED IN THE LOCKED BOX ASSIGNED TO EACH CLEARING MEMBER, OR OTHERWISE HANDLED BY THE CORPORATION, OR FOR ANY IMPROPER OR UNAUTHORIZED REMOVAL FROM ANY SUCH BOX OR FROM THE CORPORATION'S FACILITIES OF ANY SUCH TICKET, CHECK, PAPER, DOCUMENT OR OTHER MATERIAL, INCLUDING ITEMS PREPARED BY THE CORPORATION.

* * *

(ii) If any such position is being carried or maintained by a futures commission merchant which is not a Clearing Member, provide to the Corporation, on each Business Day, by the time specified by the Corporation for the purpose, the information specified in Rule 404(b) concerning any such position.

(b) Each Clearing Member shall report to the Corporation, on each Business Day, by the time specified by the Corporation for the purpose, in such manner as may be prescribed by the Corporation, the number of long and short open positions in each Contract for each expiration month which such Clearing Member is carrying for any other Clearing Member as of the close of business on the preceding Business Day. Each such report shall separately specify positions carried for such other Clearing Member's proprietary account and customer account.

**¶ 11,203**

**Rule 405. *Transfers of Open Positions***

Any transfer of a Contract shall be subject to the following:

(a) if the transferor shall have been declared to be in default, transfers may only be effected at the current day's settlement price unless the Corporation in its discretion determines that, because of excess margin on deposit or for other sufficient reason, accepting the transfer at other prices permitted by Exchange rules would not jeopardize the Corporation; and

(b) If, in any case, the Corporation in its discretion determines that it would be contrary to the best interests of the Corporation to accept a transfer at a price other than the current day's settlement price, it may, notwithstanding any provision to the contrary in the Exchange rules, require such transfer to be effected at such settlement price.

## PART 5

## Margins and Premiums

¶ 11,205

**Rule 501.** ***Approved Financial Institutions***

(a) A bank, trust company or other institution may be designated by the Board as an Approved Financial Institution for any or all of the following purposes: acting as a depository for margins and option premiums on behalf of Clearing Members, issuing or confirming letters of credit or acting in such other capacity as the Board may approve. To become designated as an Approved Financial Institution, a bank, trust company or other institution must submit an application in such form and containing such information as the Corporation from time to time may require and must meet such financial and other requirements as the Board may establish from time to time. A bank, trust company or other institution which has been designated by the Board as an Approved Financial Institution for any purpose may act as such until such designation is suspended or terminated in accordance with paragraph (d) of this Rule 501.

(b) If a bank, trust company or other institution does not meet all the requirements established by the Corporation pursuant to this Rule 501, or if the Board determines, based on such facts or considerations as the Board deems relevant or appropriate, that it would be in the best interests of the Corporation or its Clearing Members, the Board may:

(i) deny the application of such bank, trust company or institution for designation as an Approved Financial Institution,

(ii) suspend or terminate the status of such bank, trust company or institution as an Approved Financial Institution for any or all purposes, or

(iii) approve the application or permit the bank, trust company or other institution to continue as an Approved Financial Institution, subject in either case to such terms, conditions and limitations as the Board, in its judgment, deems appropriate.

(c) All checks or wire transfers by Clearing Members to the order of or to make payments to the Corporation must be drawn on or made by an Approved Financial Institution.

**¶ 11,207**

**Rule 502.** ***Margin and Premium Requirement***

(a) Each Clearing Member shall deposit with or pay to the Corporation original margin, variation margin and option premiums for each cleared Contract in such amounts, in such forms, at such times and in accordance with such systems as may be prescribed by or pursuant to these Rules or by the Board pursuant to Section 7.2 of the By-Laws.

(b) The Corporation shall retain the amount of original margin deposited with respect to any futures contract for which a delivery notice has been issued until: (i) in the case of any futures contract for which pro forma settlement is made, the Business Day after the day on which the Corporation receives the report referred to in Rule 601 that final settlement has been made, (ii) in the case of any futures contract for which pro forma

settlement is not made, the second Business Day after the applicable delivery day, and (iii) in the case of any futures contract with respect to which the Corporation has received a notice of claim pursuant Rule 401(b)(ii)(C), the day on which the Corporation receives written notice signed by both Clearing Members that final settlement has been made.

(c) The amount of variation margin on any Business Day for each account of a Clearing Member for any day shall be the net gain or loss, as the case may be, on all futures contracts in such account, represented by the difference between (i) the Settlement Price on such day of each futures contract in the account and (ii) the price at which each such futures contract was bought or sold on such day or the Settlement Price for each such futures contract in the account on the previous Business Day, as the case may be; provided, however, that in the case of any futures contract on an index, the amount of the final variation margin payment shall be determined as specified in the rules of the Listing Exchange.

(d)(i) The Agricultural Contracts Margin Committee shall consist of such number of persons as the Board shall determine from time to time, and shall have the power to establish and change original margin requirements for all agricultural contracts cleared by the Corporation.

(ii) The Financial Contract Margin Committee shall consist of such number of persons as the Board shall determine from time to time, and shall have the power to establish and change original margin requirements for all financial contracts cleared by the Corporation.

Amended by the Board December 8, 1998; effective January 29, 1999[(d)(i)(ii)].

¶ 11,208

**Rule 502-A. *Cross Margining***

(a) The Corporation may establish Cross Margining Programs with Cross Margining Clearing Organizations under which Clearing Members shall receive cross margining treatment for certain Contracts traded on or subject to the rules of each of the Exchanges which were cleared for such Clearing Member by the Corporation. The Corporation shall determine which Contracts are eligible for cross margining.

(b) Each Clearing Member shall be entitled to participate in the Cross Margining Program, and, unless the Corporation determines otherwise, no Clearing Member shall be required to establish a separate cross margining account in order to receive cross margining treatment.

Adopted by the Board April and May 1999; effective January 2000.

¶ 11,209

**Rule 503. *Cash Margin Deposits***

Each Clearing Member shall establish and maintain original margin accounts at an Approved Financial Institution of its choice with which the Corporation has entered into a cash settlement agreement containing bank holiday settlement procedures, which shall include separate proprietary and customer accounts. A Clearing Member may use such accounts for the payment of variation margin and option premiums as well as for the deposit of original margin, or may establish and maintain

a separate account at such Approved Financial Institution for its proprietary and customer accounts for the payment of variation margin and option premiums only. The Corporation shall have the right to instruct each Approved Financial Institution to debit each margin account maintained by a Clearing Member for any deposits of original margin or payments of variation margin or option premiums due to the Corporation pursuant to these Rules.

**¶ 11,211**

**Rule 504. *Mechanics for Margins and Premium Payments***

(a) The Corporation shall advise each Clearing Member of the amount of original margin, variation margin and option premiums owing to or from such Clearing Member after the close of trading on each Business Day and shall:

(i) instruct the Approved Financial Institution at which a Clearing Member maintains margin accounts to wire transfer funds in the amount due from the appropriate account of the Clearing Member at such Approved Financial Institution to the appropriate account of the Corporation; and

(ii) instruct the Corporation's bank to wire transfer funds from the appropriate account of the Corporation to the appropriate account of the Clearing Member in the amount due to the Clearing Member, provided that original margin shall not be transferred to a Clearing Member's proprietary account on any day unless that Clearing Member has deposited and paid all margins, premiums and other amounts required from such Clearing Member for the proprietary account, the customer account or

otherwise, pursuant to the By-Laws and these Rules, and original margin shall not be transferred to a Clearing Member's customer account on any day unless the Clearing Member has deposited and paid all margins, premiums and other amounts required from such customer account shall have been deposited and paid.

Variation margin under any Contract shall be paid in the currency in which such Contract is settled pursuant to the Rules of the Listing Exchange.

(b) If the Corporation determines to make an intra-day call for either original margin or variation margin, the Corporation shall:

(i) Give notice to each Clearing Member which is required to make payment to the Corporation of the amount payable by such Clearing Member; and

(ii) Immediately after giving or making reasonable efforts to give the notice described in subparagraph (i), the Corporation may instruct the Approved Financial Institution at which each such Clearing Member maintains margin accounts to wire transfer funds from the appropriate account of each such Clearing Member into the appropriate account of the Corporation in the amount due to the Corporation as determined by the Corporation.

(c) Original margin shall initially be deposited in cash as provided in Rule 504(a). Thereafter, a Clearing Member may substitute for cash on deposit as original margin securities, Approved Foreign Currencies, and/or letters of credit meeting the requirements of Rule 505 and such other instruments as may be permitted by the Board. Such substitution shall be effected by delivering to the Corporation, by the time specified by the Corporation on

the day on which the Clearing Member wishes to make the substitution:

(i) the securities, Approved Foreign Currencies, letters of credit and/or other instruments; and

(ii) a request for the release of the cash original margin for which the securities, Approved Foreign Currencies, letters of credit or other instruments will be substituted.

(d) The Corporation shall return to a Clearing Member the amount of any excess original margin on deposit from such Clearing Member, provided that the Corporation receives a request for such a release from such Clearing Member by such time as may be specified by the Corporation on the day such release is to be made.

(e) Excess original margins shall not be released pursuant to Rule 504(d) on any day if the excess margin is due to a Clearing Member's house account unless the Clearing Member has deposited and paid all margins, premiums and other amounts required from such Clearing Member for the proprietary account, the customer account or otherwise pursuant to the By-Laws and these Rules; or, if the excess margin is due to the Clearing Member's customer account, unless the Clearing Member has deposited and paid all margins and premiums required from such customer account pursuant to the By-Laws and these Rules for such account.

(f) Upon notice from the Corporation that a transfer of funds from a Clearing Member's account pursuant to Rule 504(a) was not effected as instructed by the Corporation for any reason, the Clearing Member shall deliver to the Corporation the amount required at such time and in such form as the Corporation may prescribe.

(g) Net income, if any, generated by any securities, Approved Foreign Currencies or other instruments held by the Corporation as original margin for any Clearing Member shall belong and be credited to such Clearing Member.

¶ 11,213

**Rule 505. *Deposit of Securities, Approved Foreign Currencies, and Letters of Credit as Original Margin***

(a) A Clearing Member may substitute securities for all or part of the cash it has on deposit with the Corporation as original margin, in accordance with Rule 504(c) and this Rule 505(a).

(i) The only securities eligible for deposit as original margin are Government, other sovereign debt approved by the Board and other securities deposited in accordance with cross-margining agreements with other clearing organizations.

(ii) Securities shall be valued in accordance with such methodology as may be adopted by the Board.

(iii) Every deposit of Governments shall be made by wire transfer to an account of the Corporation pursuant to such procedures and requirements as may be prescribed by the Corporation.

(iv) Any securities deposited as original margin may be sold at any time by the Corporation, with or without notice to the Clearing Member depositing the same, at public or private sale, without demand of any kind, all as the Corporation may in its discretion determine.

(v) Deposits of securities shall be made by such means and subject to such agreements and undertakings as may be prescribed by the Corporation.

(b) A Clearing Member may substitute a letter of credit or letters of credit for all or part of the cash it has on deposit with the Corporation as original margin, in accordance with Rule 504(c) and this Rule 505(b); provided that the amount of such letter or letters of credit may not exceed 50% of the amount of original margin such Clearing Member is required to have on deposit.

(i) Each such letter of credit must be issued by a financial institution selected by the Clearing Member in favor of the Corporation, provided that

(A) such institution is an Approved Financial Institution or the letter of credit issued by such financial institution has been confirmed by an Approved Financial Institution;

(B) the aggregate amount of letters of credit held by the Corporation, which are issued or confirmed by any one Approved Financial Institution, either in total or for the account or any one Clearing Member, may be limited by the Board from time to time.

(C) a letter of credit issued on behalf of a Clearing Member by an institution which is an Affiliated Person of such Clearing Member must be confirmed by an Approved Financial Institution which is not an Affiliated Person of such Clearing Member;

(D) each such letter of credit shall be in such form and in such denomination as may be prescribed by the Corporation from time to time,

shall be irrevocable, shall be available to be drawn upon by the Corporation by a clean sight draft or written demand and shall expire not less than 90 days from the date of deposit with the Corporation; and

(E) the reimbursement obligation of the Clearing Member to the issuing financial institution shall not be secured by a pledge of, lien on or other security interest in assets of the Clearing Member unless the written approval of the Corporation shall first have been obtained.

(ii) Any letter of credit deposited as original margin may be drawn upon, in whole or in part, at any time by the Corporation in its discretion.

(iii) Any letter of credit deposited by a Clearing Member as original margin shall cease to be eligible for credit against such Clearing Member's original margin obligations, from and after the fifth Business Day prior to its expiration date.

(c) A Clearing Member may substitute Approved Foreign Currencies (valued at an amount no to exceed market value less applicable haircuts as required by SEC Regulation 240.15c3-1) for all or part of the cash it has on deposit with the Corporation as original margin, in accordance with Rule 504(c) and this Rule 505(c).

(i) The Approved Foreign Currencies must be deposited in an original margin account of the Corporation either in a United States bank in the United States that is an Approved Financial Institution, or in a branch (not separately incorporated) of a United States bank that is an Approved Financial Institution located in a country which has been approved for the purpose by the Commission.

(ii) If the Approved Foreign Currencies are being substituted for cash that is customer funds, such customer funds shall remain subject to all provisions of the Commodity Exchange Act (as amended) and Commission Regulations governing the account for and segregation of customer funds.

(iii) The Corporation may convert any Approved Foreign Currencies deposited as original margin by any Clearing Member into U.S. Dollars at any time and at such exchange rate as the Corporation in its discretion may determine.

(d) If any securities deposited by any Clearing Member pursuant to this Rule 505 are sold by the Corporation, or if any letters of credit deposited by any Clearing Member pursuant to this Rule 505 are drawn upon, or if any Approved Foreign Currencies deposited by any Clearing Member pursuant to the Rule 505 are converted into US Dollars, the net proceeds thereof shall be deposited into one or more original margin accounts maintained by the Corporation and shall be credited to the customer account or the house account of such Clearing Member, as the case may be.

¶ 11,215

**Rule 506.** ***Change in Status of Approved Financial Institution***

If at any time the Board suspends or terminates the status of an Approved Financial Institution as an Approved Financial Institution to issue letters of credit to the Corporation, or if the Board shall limit or change the limit on the aggregate amount of letters of credit which may be accepted from or confirmed by any Approved Financial Institution pursuant to Rule 505(b)(i)(B), or if

any Approved Financial Institution shall exceed any limits imposed pursuant to Rule 505(b)(i)(B), any Clearing Member on whose behalf letters of credit were issued or confirmed by such Approved Financial Institution shall immediately replace the same by new original margin deposits complying with these Rules to the extent and in such amounts as the Corporation may specify.

¶ 11,217

**Rule 507. *Bank Holidays***

If an Exchange is open for trading on any Bank Holiday, the following procedures will apply:

(a) On the Business Day preceding such Bank Holiday, each Clearing Member shall deposit or pay such original margin, variation margin and option premium as may be required by the Corporation. Such deposit or payment shall be made without offset or reduction by reason of excess original margin held by the Corporation for the account of any Clearing Member.

(b) On the Business Day following such Bank Holiday, deposits and payments of original margin, variation margin and option premiums shall be made to and by the Corporation in accordance with these Rules, except that such deposits and payments shall be made with respect to transactions made both on such Bank Holiday and the Business Day preceding such Bank Holiday.

## PART 6

## Deliveries

**¶ 11,219**

**Rule 601. *Delivery Rules***

Any delivery of commodities under any Contract shall be made in accordance with these Rules and the rules of the Listing Exchange for such Contract. Each Clearing Member which is, or which carries an account which is required to make or accept physical delivery of a commodity pursuant to a CSCE futures contract which is settled by pro forma payment and delivery shall immediately notify the Corporation if and when pro forma settlement has been made and thereafter when such futures contract has been settled by final payment and delivery in accordance with the rules of the Listing Exchange.

**¶ 11,221**

**Rule 602. *Original Margin on Delivery Notices***

Each Clearing Member which issues or receives a delivery notice for a commodity under any Contract shall maintain original margin on each such Contract in accordance with these Rules and the rules of the Listing Exchange for such Contract. If any Clearing Member shall not have deposited or paid any original margin, variation margin or option premiums due from it at the time it tenders a delivery notice to the Corporation, the Corporation may decline to accept such delivery notice.

¶ 11,223

**Rule 603. *Deliveries in Bankruptcy Situations***

(a) For the purposes of this Rule 603:

(i) Notwithstanding Rule 101, the term "Customer" shall mean any person for whom a Clearing Member carries a Contract, except a non-public customer as that term is defined in Commission Regulation 190.01(b).

(ii) The term "Debtor" shall mean any Clearing Member with respect to which an Order for Relief is entered.

(b) This Rule 603 shall apply if a Clearing Member carrying a contract traded on or subject to the rules of any Exchange for any Customer becomes a Debtor, and if the rules of any such Exchange provide for physical delivery of a commodity to be made directly between such a Customer and an opposite Clearing Member which either issued a delivery notice that was assigned to such Customer or received a delivery notice that was issued by or on behalf of such Customer.

(c) By not later than 12:00 Noon on the second Business Day following the date of the entry of the Order for Relief with respect to the Debtor, or on the date payment and delivery are required under the rules of the Listing Exchange for any Contract, whichever is sooner, each Customer of the Debtor shall notify the Corporation in writing if such Customer is seeking to make or take delivery pursuant to the applicable rules of such Exchange, giving the name and address of such Customer. Upon the giving of such notice, such Customer shall assume all the obligations of the Debtor to the Corporation and the opposite Clearing Member with respect to such

Contract (but not including the obligation to deposit with or pay to the Corporation any original margin or variation margin with respect thereto, unless required by the rules of such Exchange). If, pursuant to the preceding sentence, any such Customer is not obligated to make payments of variation margin with respect to such Contract, the opposite Clearing Member shall likewise not be obligated to make payments of variation margin with respect thereto.

(i) If the Customer is seeking to make delivery, such notice shall be accompanied by

(A) evidence, satisfactory to the Corporation, that the Debtor presented delivery notice to the Corporation on behalf of the customer;

(B) a document of title as required by the rules of such Exchange for delivery of the commodity which is the subject of the delivery notice, duly endorsed, for such commodity; and

(C) such other documents as are required pursuant to these Rules and the rules of such Exchange to make delivery in fulfillment of a Contract for such commodity.

(ii) If the Customer is seeking to take delivery, such notice shall be accompanied by

(A) the delivery notice which had been assigned by the Corporation to the Debtor and allocated by the Debtor to the Customer; and

(B) a certified, cashier's or official bank check, drawn on or issued by an Approved Financial Institution and payable to the order of the Clearing Member which presented the

delivery notice, in an amount equal to such percentage of the full amount payable on delivery of the commodity as may be prescribed in or pursuant to the rules of the Listing Exchange, subject to final adjustment based on the quantity and quality of the commodity actually delivered.

(d) A Customer who gives notice pursuant to Rule 603(c) shall be deemed to agree:

(i) To perform all obligations of the Debtor under these Rules and under the rules of the Listing Exchange with respect to each Contract described in said notice (other than the obligation to deposit with or pay to the Corporation any original margin or variation margin with respect thereto, except as may be provided under the rules of such Exchange);

(ii) To be sued in any federal or state court located in the City and State of New York in any action or proceeding on or in connection with such Contract, the provisions of these Rules or of the rules of the Listing Exchange applicable thereto or performance thereunder;

(iii) To accept service of process in any such action or proceeding by United States certified mail directed to such Customer at the address set forth in such notice or by such other means provided for by law or by the rules of the court in which such action or proceeding is brought; and

(iv) That the Corporation and the opposite Clearing Member shall be discharged from their obligations and liabilities as provided in paragraph (h) of this Rule 603.

The Corporation, as a condition to permitting the Customer to make or take delivery pursuant to this Rule 603, may require such Customer to execute and deliver to

the Corporation a written agreement, in form and substance satisfactory to the Corporation, embodying the substance of the preceding provisions of this Rule 603(d).

(e) If a Customer fully complies with paragraphs (c) and (d) of this Rule 603, the Corporation shall deliver to the opposite Clearing Member the documents and/or checks received by it pursuant to paragraph (c), upon receipt from such opposite Clearing Member of such documents and/or checks as may be necessary to effect delivery or payment, and shall transmit the same to the Customer, whereupon the Corporation shall be relieved of any and all liability to the Customer, to such opposite Clearing Member and to the Debtor with respect to such Contract.

(f) THE CORPORATION SHALL HAVE NO RESPONSIBILITY TO ANY PERSON TO INVESTIGATE OR OTHERWISE VERIFY THE ACCURACY, GENUINENESS OR COMPLETENESS OF ANY DOCUMENT OR CHECK DELIVERED TO OR BY THE CORPORATION PURSUANT TO THIS RULE 603, AND SHALL HAVE NO LIABILITY TO ANY PERSON FOR THE QUANTITY OR QUALITY OF THE COMMODITY DELIVERED.

(g) Nothing contained in this Rule shall prevent a Customer and a Clearing Member from making mutually agreeable arrangements to settle delivery on terms other than those set forth in this Rule 603.

(h) The making or taking of delivery or payment or other settlement with respect to any Contract in accordance with this Rule 603, shall discharge in full the obligations and liabilities of the Customer, the opposite Clearing Member and the Corporation with respect

thereto; provided, however, that nothing contained in this Rule 603 shall relieve or discharge a Debtor from any obligation or liability it may have to the Corporation, any Clearing Member or any Customer.

## PART 7

## Option Exercise

¶ 11,225

**Rule 701. *Exercise Rules***

Any exercise of any option which is a Contract shall be made in accordance with these Rules and the rules of the Listing Exchange for such option.

¶ 11,227

**Rule 702. *Exercise of Options***

(a) Any Clearing Member which has, or carries an account which has, an open long option position may issue an exercise notice with respect to each open long option in such form and by such time as the Corporation may prescribe.

(b) After the close on the last day of trading in any option, the Corporation will automatically exercise any open long option that has a striking price below (in the case of a call option) or above (in the case of a put option) the settlement price of the underlying futures contract on that day by an amount which equals or exceeds such automatic exercise level as may from time to time be established by the Corporation for such option, unless, by such time as may be specified by the Corporation, the Clearing Member carrying any such option gives the

Corporation written instructions that any such option is to expire unexercised.

(c) The Corporation will assign exercise notices among Clearing Members which have, or carry accounts which have, open short positions in the option series being exercised, in such manner as the Corporation shall prescribe in proportion to their gross short positions in such options, separately for customer account and proprietary account.

(d) Upon exercise of any option on a futures contract, the Corporation shall make the entries on its books to convert each such exercised option into the underlying futures contract, or to effect cash settlement of such exercised option, as may be provided herein or otherwise specified by the Listing Exchange for such option.

(i) In the case of any exercise of a call option, the option positions of both Clearing Members will be reduced by the number of options exercised: the Clearing Member exercising the option will be credited on the Corporation's books with a new long position in the underlying futures contract at a price equal to the striking price of the exercised option; and the Clearing Member assigned the exercise will be credited on the Corporation's books with a new short position in the underlying futures contract at a price equal to the striking price of the exercised option. In the case of any exercise of a put option, the option positions of both Clearing Members will be reduced by the number of options exercised; the Clearing Member exercising the option will be credited on the Corporation's books with a new short position in the underlying futures contract at a price equal to the striking price of the exercised option; and the Clearing Member assigned the exercise will be

credited on the Corporation's books with a new long position in the underlying futures contract at a price equal to the striking price of the exercised option.

(ii) On the Business Day following the day of exercise of any option in which settlement is effected in cash, the Clearing Member on behalf of which the option is exercised and the Clearing Member to which the option is assigned shall receive payment from or make payment to the Corporation in accordance with the rules of the Listing Exchange for such option.

(e) Any Clearing Member that is assigned an exercise notice pursuant to any option on a futures contract must deposit and pay any original margin and variation margin required for the underlying futures contract on the next Business Day a [illegible] before the time prescribed by the Corporation.

(f) EXCEPT AS PROVIDED IN THIS RULE 702, THE CORPORATION SHALL NOT HAVE ANY OBLIGATIONS WITH RESPECT TO ANY EXCHANGE OPTION THAT IS EXERCISED.

## PART 8

## Defaults

**¶ 11,229**

**Rule 801. *Defaults***

If any of the following events ("Events of Default") shall occur with respect to any Clearing Member:

(a) If such Clearing Member fails to meet any of its obligations under its Contracts with the Corporation;

(b) If such Clearing Member fails to pay any assessments levied upon it by the Corporation when and as provided in the By-Laws;

(c) If any Monetary Default occurs with respect to such Clearing Member;

(d) If such Clearing Member fails to make any required deposit in the Guaranty Fund when and as required pursuant to the By-Laws or these Rules;

(e) If the Corporation shall determine that such Clearing Member is not in compliance with the provisions of Sections 5.2 or 5.3 of the By-Laws;

(f) If such Clearing Member commences a voluntary or a joint case in bankruptcy or files a voluntary petition or an answer seeking liquidation, reorganization, arrangement, readjustment of its debts or any other relief for the benefit of creditors under any bankruptcy or insolvency act or law of any jurisdiction, now or hereafter existing, or if such Clearing Member applies for or consents to the appointment of a custodian, liquidator, conservator, receiver or trustee (or other similar official) for all or a substantial part of its property; or if such Clearing Member makes an assignment for the benefit of creditors; or if such Clearing Member becomes or admits that it is insolvent;

(g) If an involuntary case is commenced against such Clearing Member in bankruptcy or an involuntary petition is filed seeking liquidation, reorganization, arrangement, readjustment of its debts or any relief for the benefit of creditors under any bankruptcy or insolvency act or law of any jurisdiction, now or hereafter existing; or if a custodian, liquidator, receiver or trustee (or other similar official) is appointed of the Clearing Member for all or a substantial part of its property;

(h) If a warrant of attachment, execution or similar process is issued against any substantial part of the property of the Clearing Member;

(i) If the Securities Investor Protection Corporation files an application for a protective decree with respect to such Clearing Member;

(j) If such Clearing Member holds a short futures contract position and does not tender a delivery notice on or before the time specified by the rules of the Listing Exchange on the last day on which such notices are permitted to be tendered, or fails to make delivery by the time specified in the rules of the Listing Exchange; or

(k) If such Clearing Member holds a long futures contract position and does not accept delivery or does not make full payment when due as specified in the rules of the Listing Exchange.

then, and in any such event, such Clearing Member shall automatically and without further action be suspended as a Clearing Member, except that such suspension may be temporarily postponed by the President if the President shall determine that such suspension would not be in the best interests of the Corporation, in which case the President shall immediately call a special meeting of the Board as soon as practicable, at which the Board may reinstitute such suspension or take such other action as may be provided for in the By-Laws or Rules.

¶ 11,231

**Rule 802. *Liquidation on Termination or Suspension of Clearing Member***

(a) When a Person ceases to be a Clearing Member of any Exchange or is suspended as a Clearing Member of any Exchange, all open Contracts on such Exchange carried by the Corporation for such Clearing Member shall be liquidated in the manner set forth in Rule 803 as expeditiously as is practicable unless and to the extent that:

(i) Such open Contracts are transferred to and accepted by one or more other Clearing Members, with the prior consent of the Corporation;

(ii) The Chairman, any Vice Chairman or, in the absence of the Chairman and every Vice Chairman, any director and the President determine that, in their opinion, the protection of the financial integrity of the Corporation does not require such a liquidation; or

(iii) Such liquidation is delayed because of the cessation or curtailment of trading on the Listing Exchange for such Contracts.

(b) If it is determined pursuant to paragraph (a)(ii) of this Rule 802 not to liquidate any open Contracts of a Person, or if the Corporation is unable for any reason to liquidate such open Contracts in a prompt and orderly fashion, the Chairman, any Vice Chairman or, in the absence of the Chairman and every Vice Chairman, any director and the President may authorize the execution from time to time for the account of the Corporation, solely for the purpose of reducing the risk to the Corporation resulting from the continued maintenance of such open Contracts, hedging transactions, including, without

limitation, the purchase, grant or sale of Contracts. Such officers may delegate to one or more persons the authority to determine, within such guidelines as such officers shall prescribe, the nature and timing of such hedging transactions. Any authorization of hedging transactions shall be reported to the Board not later than noon on the next Business Day, and any such hedging transactions that are executed shall be reported to the Board on a daily basis. Any costs or expenses, including losses, sustained by the Corporation in connection with transactions effected for its account pursuant to this paragraph shall be charged to such Person, and any gains, net of any costs and expenses, shall be credited to such Person.

¶ 11,233

**Rule 803.** ***Method of Closing Out***

(a) The open Contracts of any Person which, pursuant to Rule 802, are required to be liquidated pursuant to this Rule 803, shall be liquidated in such manner as the Corporation, in its discretion, may direct. Without limiting the generality of the foregoing:

(i) Any such liquidation may be effected by placing, with one or more Exchange members chosen at the discretion of the President, or, in the absence of the President, any Vice President, orders for the purchase, grant, exercise, or sale of Contracts.

(ii) Contracts on opposite sides of the market, having different expiration months, may be liquidated by spread or straddle transactions (regardless of whether they are held for different accounts or different beneficial owners), in which case the price for each Contract in any such spread or straddle shall be determined as follows: an amount equal to one-half

of the price differential at which the spread or straddle is executed shall be added to the median between the settlement prices for Contracts having the same expiration months as the two Contracts involved on the prior trading day in order to determine the price for the Contract having the higher prevailing market value at the time the spread or straddle is executed, and subtracted from such median in order to determine the price for the Contract having the lower prevailing market value at the time the spread or straddle is executed. If the President believes that setting the prices as prescribed in the preceding sentence would produce an inequitable result in any particular case, the prices may be set in such other manner as may be approved either by any two Board members or by one such Board Member and the President of the Corporation.

(iii) Options may be liquidated by closing transactions or by exercise, in the discretion of the President, and in any case where an option is exercised, the Corporation may liquidate the underlying futures contract, if any, resulting from such exercise in accordance with this Rule.

(iv) The Person whose Contracts are liquidated shall be liable to the Corporation for any commissions or other expenses incurred in liquidating such Contracts.

(v) Notwithstanding any other provisions of this Rule 803(a), any such liquidation may be effected without placing orders for execution on the floor, by making appropriate book entries on the records of the Corporation (including, without limitation, by pairing and canceling offsetting long and short positions in the same delivery months of a futures contract or in the same option series carried by a Clearing Member)

at a price equal to the settlement price or settlement premium on the day such liquidation is ordered or at such other price as the Board may establish; provided, however, if an Order for Relief has been entered with respect to such Person, the Corporation will not effect any such liquidation by book entry except as may be permitted by Commission Regulations.

(b) If, as a result of the rules of the Listing Exchange limiting fluctuations in price or other circumstances, it is not possible to liquidate all net open Contracts pursuant to Rule 803(a)(i), the Corporation may liquidate such Contracts by taking opposite positions in the current expiration month and liquidating the resultant offset positions by a spread or straddle.

(c) All liquidations made pursuant to this Rule 803 shall be for the account and risk of the Person which ceases to be a Clearing Member or which is suspended as a Clearing Member. NEITHER SUCH PERSON NOR ANY OTHER PERSON SHALL HAVE ANY CLAIM OR RIGHT AGAINST THE CORPORATION REGARDING THE TIMING OF LIQUIDATION OR THE MANNER IN WHICH OR THE PRICE AT WHICH CONTRACTS HAVE BEEN LIQUIDATED PURSUANT TO THIS RULE 803.

**¶ 11,235**

**Rule 804.** ***Amounts Payable to the Corporation***

Upon completion of the liquidation or transfer of the positions of a Person pursuant to Rule 803, the Corporation shall be entitled on demand to recover from such Person all amounts due to the Corporation for all

losses, liabilities and expenses (including without limitation legal fees and disbursements) incurred by the Corporation in connection with such liquidation or transfer.

**¶ 11,237**

**Rule 808. *Reinstatement of Suspended Member***

Any Clearing Member suspended pursuant to Rule 801 may apply for reinstatement as provided in Rule 905.

## PART 9

## Disciplinary Proceedings

**¶ 11,239**

**Rule 901. *Rule Violations***

(a) Except as provided in paragraph (b) of this Rule 901, the Corporation shall refer any suspected violation of the By-Laws or these Rules by any Clearing Member to the enforcement staff of any Exchange of which such Clearing Member is a member for appropriate action, in accordance with the rules of such Exchange.

(b) The President or his designee may summarily impose a fine against any Clearing Member:

(i) for failing to make timely payments to the Corporation of original or variation margin, option premiums, dues, fees, fines, assessments or other charges, and

(ii) for failing to make timely and accurate submissions to the Corporation of notices, reports, or other information required under any provision of the By-Laws or these Rules.

The amounts of the fines for any category of violations which may be imposed pursuant to this Rule 901(b) shall be set by the Board from time to time, provided that the maximum fine for any one violation shall not exceed $10,000. Nothing contained in this Rule 901(b) shall preclude any other action against a Clearing Member pursuant to Rule 901(a) or otherwise with respect to conduct described in this Rule 901(b). The imposition of a fine pursuant to this Rule 901(b) shall be the final action of the Corporation if a request to review such fine shall not be submitted to the Board by the Clearing Member when and as provided in Rule 902.

¶ 11,241

**Rule 902. *Summary Imposition of Fines; Request for Review***

The Corporation shall give a Clearing Member written notice of a fine imposed pursuant to Rule 901(b). Such notice shall specify the date of the occurrence for which the fine is being imposed, the provision or provisions of the By-Laws or Rules giving rise to the fine and the amount of the fine. Within ten days of the giving of such notice, the Clearing Member

(a) shall pay such fine, or

(b) at its election, may submit a written request to the Board to review such fine. Any such request shall specify the basis for such review.

¶ 11,243

**Rule 903.** ***Review of Summary Fine by Board***

(a) The Board shall hear and consider a request for review made pursuant to Rule 902 at the next regular meeting of the Board held more than two weeks after the date on which such request for review is received by the Corporation.

(b) At the Board meeting at which the request for review is heard and considered, the Clearing Member may appear and present evidence to establish that it did not commit the violation for which the fine was imposed and/or that the fine imposed is excessive, and the staff of the Corporation may present evidence to establish that such Clearing Member did commit such violation and/or that such fine was not excessive.

(c) The Board shall not be bound by formal rules of evidence or by technical considerations. The Board shall follow such procedures as it deems best calculated to ascertain material information and otherwise to insure a fair and impartial hearing.

(d) The Board shall issue a written decision and shall provide a copy of such decision to the President and the Clearing Member. The decision may affirm, cancel, decrease or increase any fine imposed pursuant to Rule 901(b), subject to the maximum set forth therein. Such decision shall be the final act of the Corporation.

¶ 11,245

**Rule 904. *Hearings in Financial Emergencies***

(a) If at any time the Board, in its sole discretion, determines that there is a substantial question as to whether a Financial Emergency exists with respect to any Clearing Member, the Board may suspend, or take any other action against, involving or with respect to such Clearing Member and/or any Affiliated Person of such Clearing Member which is also a Clearing Member as the Board may deem necessary or appropriate.

(b) Any action taken against, involving or with respect to any Clearing Member pursuant to this Rule shall be taken after notice and an opportunity to be heard, unless (i) such Clearing Member shall have waived the right to such notice and opportunity, or (ii) the Board in its sole discretion shall determine that (A) giving such notice or opportunity to be heard before taking such action is not practicable under the circumstances, and (B) there is reason to believe that immediate action is necessary to protect the best interests of the marketplace. Any such notice shall be given not later than one hour before the hearing.

(c) In any case in which action is taken against, involving or with respect to a Clearing Member without prior notice and opportunity to be heard, the Corporation shall give such member notice and an opportunity to be heard promptly thereafter. Every such notice shall (i) state the action taken, (ii) briefly state the reasons for the action and (iii) state the effective time, date and duration of the action.

(d) In any hearing pursuant to this Rule the Board shall not be bound by formal rules of evidence or by technical considerations. The Board shall follow such procedures as it deems best calculated to ascertain material information and otherwise to insure a fair and impartial hearing.

(e) At the hearing, the President shall present such evidence and considerations as may tend to show that there is a substantial question as to whether a Financial Emergency exists with respect to such Clearing Member, and the Clearing Member may present such evidence and considerations as may tend to show that no such question exists. The Clearing Member may be represented by legal counsel or any other representative of its choosing at such hearing. A substantially verbatim record of the hearing shall be made, but need not be transcribed unless the Clearing Member so requests or the Corporation so determines.

(f) The Board shall issue a written decision and shall provide a copy of such decision to the President and the Clearing Member, together with a copy of any transcript that may have been made of the hearing and copies of any documents that may have been presented at the hearing. The decision shall include a statement of the Board's determination as to whether there is a substantial question as to whether a financial emergency exists with respect to such Clearing Member and, if so, a description of any action taken, including the affirmance, modification or reversal of any action therefore taken, and the effective date and duration of the action. Such decision shall be the final action of the Corporation and shall not be subject to appeal within the Corporation.

¶ 11,247

**Rule 905. *Reinstatement of Suspended Member; Revocation or Modification of Other Actions***

A Clearing Member which has been suspended pursuant to Rule 801 or 904, or which has been the subject of any other action pursuant to Rule 904, may seek reinstatement or revocation or modification of such action by submitting an application therefore in such form and accompanied by such information as the Corporation may prescribe. Such application may be rejected or granted in whole or in part by the Board in its discretion.

¶ 11,249

**Rule 906. *Conflicts of Interest***

A member of the Board may not participate in any proceedings conducted pursuant to this Part 9 if such member or any Affiliated Person of such member directly or indirectly has a financial, personal or other interest in the matter under consideration.

¶ 11,251

**Rule 907. *Liability for Expenses***

Any Clearing Member which, after notice and opportunity for hearing pursuant to these Rules, has been found by final action of the Corporation to have violated any By-Law or Rule, or has been the subject of action taken pursuant to Rule 904, may, in the discretion of the Corporation, be required to pay to the Corporation an amount equal to any and all expenses incurred by the Corporation (including without limitation legal and accounting fees and expenses) incurred in investigating

the matter, preparing the matter for referral to an Exchange or for submission to the Board, or otherwise in connection with such violation or action, as the case may be, in addition to any fine or other penalty which may be imposed on such Clearing Member.

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No. 06-1265

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SUPREME COURT, U.S.

In The
# Supreme Court of the United States

KLEIN & CO. FUTURES, INC.,

*Petitioner,*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., ET AL.,

*Respondents.*

**On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit**

## BRIEF OF PETITIONER

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## QUESTION PRESENTED

Whether the court of appeals erred in concluding that petitioner, as a futures commission merchant (FCM), lacked statutory standing to invoke the right of action under 7 U.S.C. § 25(b)(1), because, in the court's view, it did not engage in "any transaction on or subject to the rules of" respondents, despite the statutory requirement that FCMs enter into and execute their transactions on, and subject to the rules of, respondents and the fact of FCMs' financial liability for the transactions.

## PARTIES TO THE PROCEEDING

Petitioner is Klein & Co. Futures, Inc. The respondents were appellees in the court of appeals, and consist of the Board of Trade of the City of New York, Inc., the New York Clearing Corporation, the New York Cotton Exchange, Inc., and the New York Futures Exchange.

Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peres, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Nitesh Trivedi, Joseph O'Neill, Walter Fair, Evan Thomas, Joseph Jach, Norman Eisler, and First West Trading, Inc. also were appellees in the court below, but petitioner does not seek review of the court of appeals' ruling affirming their dismissal from the case.

## RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of the Supreme Court, petitioner Klein & Co. Futures, Inc. hereby states that it has no parent company, and no public company owns 10% or more of its stock.

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## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 464 F.3d 255 (2006). Pet. App. 1a-15a. The opinion of the United States District Court for the Southern District of New York granting respondents' motion for summary judgment is unreported. Pet. App. 16a-34a.

## STATEMENT OF JURISDICTION

The court of appeals entered its judgment on September 18, 2006. A petition for rehearing and rehearing *en banc* was denied on November 14, 2006. Justice Ginsburg, on January 31, 2007, granted an extension of time within which to file a petition for a writ of *certiorari* to and including March 14, 2007. Petitioner timely filed its petition for a writ of *certiorari* on March 14, 2007. This Court granted the petition on May 21, 2007. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

## STATUTE INVOLVED

Section 22 of the Commodity Exchange Act, 7 U.S.C. § 25(b)(1), as in effect when this case was filed on July 26, 2000, provides in relevant part as follows:

> **§ 25. Private rights of action**
>
> * * *
>
> **(b) Liabilities of organizations and individuals; bad faith requirement; exclusive remedy**
>
> (1)(A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by section 7(a)(8) and section 7(a)(9) of this title,
>
> (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or

> (C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this chapter or any Commission rule, regulation, or order,
>
> shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

7 U.S.C. § 25(b)(1) (1994). Additional provisions of the statute are set forth at App., *infra*, 1a-7a.

## INTRODUCTION

This case arises out of the failure of respondent New York Futures Exchange (NYFE), its clearinghouse respondent New York Clearing Corporation (NYCC), and the other respondents to enforce their rules to ensure against gross misconduct by the Chairman of NYFE.[1] The failure to enforce the rules caused catastrophic loss to petitioner Klein & Co. Futures, Inc., and destroyed that business based on the fraudulent manipulation of settlement prices of certain positions in the commodity futures market by the NYFE Chairman.

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[1] Respondent NYFE, as of May, 2000 when this action accrued, was a wholly-owned subsidiary of respondent New York Cotton Exchange (NYCE), which was a wholly-owned subsidiary of respondent Board of Trade of the City of New York (NYBOT). At that time, respondent NYCC also was a wholly-owned subsidiary of respondent NYBOT. NYCC cleared the trades for the various NYBOT exchanges, including NYFE. Petitioner was a member of each of the four respondent entities and thus was subject to the rules of each of them.

On January 12, 2007, IntercontinentalExchange (ICE) acquired NYBOT, making NYBOT a wholly-owned subsidiary of ICE and part of a for-profit, publicly traded corporation for the first time in its history.

The court of appeals erred in holding that petitioner did not have standing to bring this action against respondents under Section 22(b)(1) of the Commodity Exchange Act, 7 U.S.C. § 25(b)(1) (1994), to recover its actual losses caused by bad faith conduct of respondents. Section 25(b)(1) was designed precisely to authorize futures commission merchants (FCMs) like petitioner to bring such actions as part of the overall enforcement scheme created in the Commodity Exchange Act to protect the integrity of the nation's commodity futures markets from self-dealing or other malfeasance by exchanges and their clearinghouses. The court of appeals misread the plain text of the statute and relied on a fundamental misconception about the operation of the commodity futures markets to hold that only purchasers and sellers of futures contracts have standing under Section 25(b)(1).

Simply put, Section 25(b)(1) authorizes suit to be brought against respondents by a person who has "engaged in any transaction on or subject to the rules" of an exchange or its clearinghouse. *Ibid.* Petitioner plainly met this requirement. The rules of the exchange required that any contract made on the exchange "shall be made on behalf of a clearing member," such as petitioner, "who shall be the buyer or seller of said contract on the terms set forth therein" and that the clearing member shall assume as its own the futures contracts on the exchange. *See* NYFE Rule 306(i)(2) (App., *infra*, 14a). The clearing member then submits the contract for clearing on the clearinghouse, which consummates the transaction. Petitioner was financially liable to the clearinghouse for any losses on the clearing transaction, NYCC By-Law 5.5(a) (J.A. 131-132), and was an indispensable party to that transaction because clearinghouses allow only members like clearing FCMs to perform that function, *id.* at 5.1 (J.A. 119). As such, the court of appeals' holding that petitioner did not engage in a transaction on or subject to the rules of the exchange or clearinghouse defies all logic.

## STATEMENT OF THE CASE

### A. Overview Of The Commodity Futures Market

1. Futures contracts began trading on organized exchanges in Chicago in the mid-1800s. *See* Chicago Board of Trade, *Commodity Trading Manual* 5 (1994) (hereinafter *Commodity Trading Manual*). The Chicago Board of Trade was the first such organized exchange, established in 1848 by 82 merchants. The exchange provided a physical location for buyers and sellers to trade commodities, such as grain or cattle, through the use of forward contracts – *i.e.*, contracts for the future delivery of specified commodities. These early forward contracts had significant drawbacks, however, because they were not standardized according to quantity, quality, or delivery time, and merchants or traders often failed to fulfill their forward commitments because of their refusal or inability to make or to take timely delivery of the commodity on the agreed upon delivery date.

In 1865, the Chicago Board of Trade formalized trading by the creation of agreements called "futures contracts," which imposed a standardization that had been lacking. *Ibid.*; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 358 (1982). In addition, the Chicago Board of Trade instituted a margin system, which required the deposit of funds to minimize counterparty risk and to help guarantee future performance. *See Commodity Trading Manual* 5.

A modern futures contract imposes an obligation to buy or sell a specified amount of a commodity at an agreed upon price on a certain date in the future. The seller of a futures contract (the short position) is obligated to make the delivery of the commodity, *i.e.*, sell, on the date specified by the contract. Conversely, the buyer of a contract (the long position) is obligated to take delivery of the commodity, *i.e.*, buy, on the date specified by the contract. All of the terms of a modern futures contract are standardized, except for price which is established or "discovered" by the buyers and sellers in the futures market.

Delivery rarely occurs on the futures market because the ongoing obligation of a buyer or seller of a futures contract is almost always "offset," and thus closed, through the purchase or sale of an equal and opposite contract. *See* Chicago Board of Trade, *Handbook of Futures & Options* 10 (2006) (hereinafter *Handbook of Futures & Options*); *Curran*, 456 U.S. at 357-358. For example, a purchaser of a futures contract in January for a 5000 ounce silver contract with a March delivery date can offset and close this position at any time between the January purchase and the March date by selling an identical 5000 ounce silver contract with the same delivery date.

2. The commodity futures market serves a well-recognized, important public interest. The purchase or sale of futures contracts on commodities markets helps to discover the cash price for goods and reflects a market price for the underlying tangible commodity. "The prices involved in [futures] transactions are generally quoted and disseminated throughout the United States and in foreign countries as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof and to facilitate the movements thereof in interstate commerce." 7 U.S.C. § 3 (1994).

Futures contracts assist the participants in the cash market (*e.g.*, producers, middlemen, commercial users or processors of a commodity), who are known as "hedgers," to protect themselves from, *i.e.* hedge against, adverse price fluctuations of the physical commodity in which they deal. *Ibid.* ("[Futures contracts] are utilized by shippers, dealers, millers, and others engaged in handling commodities and the products and byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price.").

For example, a manufacturer of soybean oil who enters into a business contract to deliver its oil several months in the future can hedge against a price increase in the market for the soybeans that are its raw material. The oil producer need only buy a sufficient number of futures

contracts in soybeans with a delivery date for when he will need to actually buy soybeans in the future. Thus, if the manufacturer knows it will need 5,000 bushels of soybeans in March, it can buy a 5,000 bushel futures contract of soybeans in January at $7 a bushel. Then, if the price of soybeans rises to $9 a bushel by March, the futures contract will likewise rise and can be sold to offset the increased price of the underlying commodity. In order to gain this protection against adverse price movements, the hedger must, however, surrender its ability for a greater profit than could be gained from favorable price changes. Thus, if the price of soybeans declines to $5 a bushel, the same futures contract prevents the manufacturer from realizing a greater profit (because the soybeans are less expensive at $5 a bushel, but offsetting the futures contract position at $7 a bushel will be more expensive). The oil manufacturer uses this hedging opportunity when the benefit of the protection against too great a price increase for its raw material outweighs the cost of sacrificing the possible greater profit. The National Futures Association (the congressionally authorized self-regulatory organization of the industry, *see*, *infra*, note 9) explains as follows:

> Whatever the hedging strategy, the common denominator is that hedgers willingly give up the opportunity to benefit from favorable price changes in order to achieve protection against unfavorable price changes.

National Futures Association, *Opportunity and Risk, An Education Guide to Trading Futures and Options on Futures* 19 (2006), *available at* http://www.nfa.futures.org/investor/OppRisk/OppRisk.pdf (last visited July 16, 2007).

In addition to hedgers, speculators participate in the commodity futures market. They do so as an investment strategy. Speculators "seek to profit from anticipated increases or decrease in future prices. In so doing, they help to provide the capital needed to facilitate hedging." *Ibid.*

3. Today, futures contracts are traded on various organized exchanges, which are boards of trade that are

designated as contract markets, *see* 7 U.S.C. § 7, such as respondent Board of Trade of the City of New York (NYBOT) and, at the time this action accrued, respondent New York Futures Exchange (NYFE).[2] Each exchange operates a market for trading in contracts in certain commodities. *See, e.g.*, http://www.nybot.com (last visited July 13, 2007). Trading on an exchange is limited to members of that exchange and affiliated persons.

The trading of futures contracts has long occurred through a competitive, open outcry bidding on the floors of exchanges. Members of the exchange and their brokers gesture with pre-defined hand signals and shout to each other bids and offers in trading pits located on the exchange floor. *See Commodity Trading Manual* 35.[3] In more recent years, bids and offers also are posted by electronic means so that they can be matched without face-to-face contact between the members on the exchange.

The agreement to buy and the agreement to sell that occur on the exchange do not consummate a futures contract, however. A transaction for a futures contract is completed by the act of clearing the trade which takes place at the exchange's clearinghouse, such as respondent New York Clearing Corporation (NYCC). Trades can be cleared only by a clearing FCM, like petitioner Klein & Co. Futures, Inc., which must be well-capitalized and a member of the clearinghouse. Indeed, respondent NYFE's rules dictate that every contract made on the exchange shall be for the "clearing member who shall be the buyer or seller of said contract" and "shall be assumed" by that

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[2] Options contracts are traded on such exchanges as well. An option contract gives an investor the option (*i.e.*, the right, but not the obligation) to enter into a particular futures contract during a particular period of time at a particular price. The instant dispute involves both futures contracts and their options but, for the purposes of this Court's review, the distinctions between the two make no difference and we use the term "futures contracts" to refer to both.

[3] For a fuller description of the exchange floor and trading pits, *see Handbook of Futures & Options* 24-25.

clearing FCM within one hour of a trade's execution. *See* NYFE Rule 306(i)(2) (App., *infra*, 14a).

Through the clearing transaction, one clearing FCM becomes responsible to the clearinghouse for the short position in the trade, another clearing FCM becomes responsible to the clearinghouse for the long position in the trade, and the clearinghouse becomes the counterparty to both FCMs. Respondent NYCC has explained: "[i]n each mutually confirmed transaction, [NYCC] is substituted as the buyer to the selling clearing member and the seller to the buying clearing member." NYCC Statement (App., *infra*, 19a);[4] *see also Handbook of Futures & Options* 60. A

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[4] The NYCC Statement was previously available on NYCC's website, and was cited in the brief of the Futures Industry Association as *amicus curiae* in support of petitioner before the Second Circuit. The statement is not currently on their website, but is available online as it existed in August 2005 on a not-for-profit internet archiving site at http://web.archive.org/web/20050823002032/209.208.183.6/generalInformation/aboutNYCC/aboutNYCC.htm. It is also reproduced in the appendix to this brief. App., *infra*, 19a.

Descriptions by the Commodity Futures Trading Commission and the Chicago Mercantile Exchange (CME) clearinghouse are in accord with NYCC's statement. Specifically, the CME describes the act of clearing as follows:

> Clearing members assume full financial and performance responsibility for all transactions executed through them and all positions they carry. CME Clearing, dealing exclusively with clearing members, holds each clearing member accountable for every position it carriers regardless of whether the position is being carried for the account of an individual member, for the account of a non-member customer, or the clearing member's own account. Conversely, as the contra-side to every position, CME Clearing is held accountable to the clearing members for the net settlement from all transactions on which it has been substituted as provided in the Rules.

CME Clearing, *Financial Safeguards* at 2 (2006), *available at* http://www.cme.com/files/financialsafeguards.pdf (last visited July 16, 2007); *see also* Commodity Futures Trading Commission, *Glossary*, *available at* http:/www.cftc.gov/opa/glossary/opaglossary_c.htm (last visited July 16, 2007) (same).

clearing FCM is therefore at the center of a commodity futures trade.

4. The exchange's clearinghouse thereby protects other participants in the market from adverse financial consequences of a default by removing counterparty risk in a futures contract. This is accomplished by severance of any relationship between the buyer and seller on the exchange, so that a trade is comprised of several separate but coordinated transactions, including between the buyer or seller and its clearing FCM, and the clearing FCM and the clearinghouse. Through this series of transactions, clearing firms "do not create financial obligations to one another but, rather, to the clearinghouse" and "nonclearing firm buyers and sellers create obligations not to each other but to the clearing firm that clears their trades." *Handbook of Futures & Options* 60.

Under this system, the clearinghouse and its clearing member FCMs are financially responsible for every trade that occurs on the exchange. Therefore, clearinghouses require that their members, *i.e.*, the clearing FCMs, deposit with the clearinghouse performance bond money called "margin" to guarantee the clearing FCMs' performance. Clearing FCMs, in turn, require their customers to post similar margin with them to cover the customers' own market positions. *See id.* at 18.

The original margin, when the futures contract is first executed and cleared, is set to be consistent with the level of market risk in the commodity. But the price and risk of a futures contract in a particular commodity changes from day to day. Accordingly, after each trading session, the exchange, in accordance with its rules and bylaws, calculates a settlement price for each commodity, *see* NYFE Rule 315 (App., *infra*, 14a-15a), which is supposed to reflect that commodity's end of trading day market value. That settlement price is transferred to the clearinghouse, so that the clearinghouse can reconcile its

clearing members' positions in the aggregate and the day's winners and losers in the market can be determined.[5]

It is the settlement price that is used to determine the gain or loss for each position open at the end of the day. If a clearing FCM's positions, in the aggregate, lose money on the day, a variation margin payment may be required, and the clearing FCM may be required to deposit additional margin to the clearinghouse, before the next day, or even earlier in times of significant market volatility. Conversely, if a clearing FCM's position gains money, the clearinghouse may return the excess margin to that FCM.

A clearing FCM undertakes a similar calculation based on the settlement price with respect to the buyers and sellers whose trades it cleared. Those customers will be required to deposit more funds into their account with the clearing FCM if they lose based upon the settlement price, and customers that win may be entitled to receive excess funds in their account.

Transactions in futures contracts differ significantly from the typical purchase of securities in this regard. Ownership of an underlying security is transferred in the typical securities transaction either through the payment of cash or by an extension of credit. By contrast, participants in the commodity futures market are required to post margin that is a performance bond – which is often

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[5] The CFTC explained in its administrative order addressing the misconduct by the NYFE chairman related to this case:

> For positions held since the previous trading day, the variation payment is the difference between the settlement price that day and the settlement price on the previous day. For positions acquired during the day and held at the end of the day, the variation payment is the difference between the trade price and the settlement price. Clearinghouses pay (or collect) variation payments to (or from) their members for the members' daily variation.

*Matter of Norman Eisler*, CFTC No. 01-14, at 3 (C.F.T.C. Jan. 20, 2004), available at http://www.cftc.gov/files/enf/04orders/enfeisler-order.pdf (last visited July 13, 2007).

only between 2 and 5 percent of the contract's face value – to ensure that they can fulfill their contract obligations in the future.

### B. Federal Regulation Of Commodity Futures Exchanges Through Public And Private Enforcement

Organized commodity futures exchanges have relied upon self-regulation for more than one hundred and fifty years. The rules and by-laws of the exchanges and of the clearinghouses have been designed to support competitive, efficient, and liquid markets free from undue manipulation. Even though the commodity futures market is subject to extensive federal oversight, the primary responsibility for market surveillance and protection of the integrity of the futures market remains with the exchanges themselves. *See* 7 U.S.C. § 5(b) ("It is the purpose of this chapter to serve the public interests * * * of this section through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals"); Comptroller General of the United States, Report to Congress, *Commodity Futures Regulation – Current Status & Unresolved Problems* 48 (1982); CFTC, *Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations*, 72 Fed. Reg. 6936, 6938 (Feb. 14, 2007) (to be codified at 17 C.F.R. pt. 38) ("Congress established a statutory system of [exchange] self-regulation, combined with [federal] oversight, to promote 'responsible innovation and fair competition among boards of trade, other markets and market participants.'") (citations omitted).

1. Federal regulation of the commodity futures market began with the Grain Futures Act of 1922, Pub. L. No. 331, 42 Stat. 998 (1922), which mandated that futures trading in certain enumerated commodities, such as grain and flaxseed, could occur only on federally

licensed exchanges, *id.* at § 4(b).[6] Fourteen years later, Congress enacted the Commodity Exchange Act of 1936 (CEA), Pub. L. No. 74-675, 49 Stat. 1491 (1936), in order to strengthen the federal government's oversight of the market. The CEA extended government oversight to trading in cotton and certain other specified agricultural commodities. Importantly, the CEA also imposed federal regulation on the licensing of exchanges and registration requirements on other market participants, such as FCMs. *Curran*, 456 U.S. at 362.

In 1968, Congress amended the CEA to require exchanges to enforce their own rules as part of the self-regulatory process. The federal government also gained the power to disapprove any exchange rules that were inconsistent with the CEA. Commodity Exchange Act Amendment of 1968, Pub. L. No. 90-258, 82 Stat. 26 (1968); *Curran*, 456 U.S. at 364.

Significant expansion of the regulation of the commodity futures market occurred again in 1974 when Congress enacted the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974). Under that Act, Congress extended federal regulation to *all* commodities. 7 U.S.C. § 1a(4) (1994). The 1974 law also created the Commodity Futures Trading Commission (CFTC), which is an independent federal agency comprised of five full-time commissioners and a staff. Commodity Futures Trading Commission Act, § 101, 88 Stat. at 1389.

Congress further amended the CEA in various respects, including in 1982 when it codified the private right of action set forth in 7 U.S.C. § 25(b)(1) (1994), which is at issue in this case.

2. Congress ensures that exchanges self-regulate and enforce their rules in a manner consistent with the

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[6] Congress first authorized the regulation of the commodity futures market in 1921 with the Futures Trading Act, 42 Stat. 187 (1921), but that Act was held unconstitutional in *Hill v. Wallace*, 259 U.S. 44 (1922), as exceeding Congress's taxing power. *Curran*, 456 U.S. at 361.

public interest by requiring that the CFTC conduct investigations and initiate enforcement actions. *See, e.g.*, 7 U.S.C. §§ 7, 7a, 7a-1, 8; 7 U.S.C. §§ 7, 7a, 7b, 8 (1994). And this authority applies to the exchanges' clearinghouses because exchange rules include the rules of their clearinghouses. 17 C.F.R. § 1.41(a)(3) (1999); *see also* CFTC, *Contract Market Rules and Authority Delegation*, 41 Fed. Reg. 40,091, 40,093 (Sept. 17, 1976) ("a meaningful distinction cannot be drawn between the rules of the clearing organization and the contract market for purposes of" 7 U.S.C. § 7a).

In addition, the CFTC has authority to enjoin improper exchange behavior; to alter or to supplement an exchange's rules; to suspend or to revoke an exchange's designation as a contract market (*i.e.*, elimination of the ability to operate as a forum for the purchase or sale of futures contracts) if the exchange fails to enforce the statute, the agency's regulations, or the exchange's own rules; and to direct a contract market to take any action deemed necessary by the Commission in an emergency. 7 U.S.C. §§ 13a, 13a-1, 8, 12a(7), 12a(9) (1994).

Private enforcement is also explicitly provided for by Congress. The CEA grants an administrative remedy to individuals injured by any entity that is required to be registered by the CFTC, which includes members of the exchanges such as FCMs, although not the exchanges themselves. *See* 7 U.S.C. § 18. With regard to the exchanges, a private civil action against exchanges (and other market participants) was "routinely and consistently" recognized as an implied private right of action under the CEA. *Curran*, 456 U.S. at 379; *see also Leist v. Simplot*, 638 F.2d 283, 299-300 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982) (collecting cases).

In 1982, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, this Court held that the administrative remedies created under the CEA in 1974 had supplemented, not replaced, the previously recognized implied private rights of action under the CEA. 456 U.S. at 384-387. The Court

emphasized that the private right of action differed substantially from the administrative remedies, including because the administrative remedies for private litigants, were "not available against the exchanges," but the private right of action was so available. *Id.* at 384. The Court acknowledged the significance of the continuing availability of the private right of action under the CEA, noting that the United States believed that "the private cause of action enhances the enforcement mechanism fostered by Congress over the course of 60 years." *Id.* at 387.

3. Not long after the *Curran* ruling, Congress codified in 7 U.S.C. § 25, *see* Futures Trading Act of 1982, Pub. L. No. 97-444, § 235, 96 Stat. 2294, 2322-2324 (1983), the private civil action against various participants in the market, including against exchanges.

Section 25 provides multiple distinct causes of action against four different categories of defendants set forth in Sections 25(a)(1), 25(b)(1), 25(b)(2), and 25(b)(3), for violations of the CEA and/or failure to enforce rules, bylaws or regulations as required by the CEA. The persons who can bring suit against the different types of defendants are also different in each provision:

- Section 25(a) authorizes suit *against* FCMs, traders, or other persons or firms who are not an exchange or its clearinghouse.

  A suit under Section 25(a) can be *brought* only by persons who: (A) "received trading advice" from the putative defendant for a fee; (B) made a futures contract through the defendant or deposited money with an order to do so; (C) "purchased from or sold to" the defendant or placed through it certain futures options or contracts; or (D) "purchased or sold" a futures contract through the defendant "if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract." *Id.* § 25(a)(1)(A)-(D) (1994).

- Section 25(b)(1) authorizes suit *against* "a contract market [*i.e.*, an exchange] or clearing organization of a contract market," or "a licensed board of trade."

A suit under Section 25(b)(1), *i.e.*, the suit at issue here, can be *brought* only by a person "who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade." *Id.* § 25(b)(1) (1994).[7]

- Section 25(b)(2) authorizes suit *against* registered futures associations.[8]

A suit under Section 25(b)(2), can be *brought* only by a person that engaged in "any transaction specified in subsection (a)," *i.e.* Section 25(a)(1)(A) to (D). *Id.* § 25(b)(2) (1994).

- Section 25(b)(3) authorizes suit *against* an officer or other specified individual at a contract market, clearinghouse, licensed board of trade, or registered futures association.

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[7] It has been clear since at least 1976, that, with respect to such a reference to the rules of a contract market, "[t]he term contract market includes a clearing organization that clears trades for the contract market." 17 C.F.R. § 1.41(a)(3) (1999); CFTC, Contract Market Rules and Authority Delegation, 41 Fed. Reg. 40,091 (Sept. 17, 1976). Accordingly, respondents cannot succeed on the argument (*see* Br. in Opp. 14-15, 21-22) that, despite the inclusion of "clearing organization" as an identified defendant, this provision somehow does not permit a suit for a transaction conducted on or subject to the rules of a clearing organization.

The 2000 amendment to Section 25(b)(1) neither expanded nor contracted the private rights of action under the CEA. It was a technical and conforming amendment that substituted the term "registered entity" in certain places for the terms "contract market," "clearing organization of a contract market," and "board of trade," *compare* 7 U.S.C. § 25 (present statute), *with* 7 U.S.C. § 25 (1994), in order to correspond with the new definition of "registered entity" added in 7 U.S.C. § 1a(29), that includes boards of trade designated as contract markets and clearing organizations, as registered entities. *See* Commodity Futures Modernization Act of 2000, Pub. L. No. 106-580, 114 Stat. 2763 (2000).

[8] A "registered futures association" is a self-regulatory organization, such as the National Futures Association, that regulates the firms and individuals who conduct futures trading with public customers.

> A suit under Section 25(b)(3), can be *brought* only by a person that engaged in "any transaction specified in subsection (a)," *i.e.*, Section 25(a)(1)(A) to (D), if the defendant is at a registered futures association. If the defendant is at a contract market, clearinghouse, or board of trade, the person must not only have engaged in a "transaction specified in subsection (a)," but that transaction must have been "on, or subject to the rules of" such contract market or board of trade. *Id.* § 25(b)(3) (1994).

## C. FACTUAL BACKGROUND[9]

Petitioner Klein & Co. Futures Inc. was a member of each of the respondents. Thus, petitioner was a clearing FCM that executed trades on NYFE and also assumed trades made on NYFE and cleared those contracts with NYCC.

The chairman of respondent NYFE, Norman Eisler, was on NYFE's committee that set the settlement price each day for the futures contracts at issue here, "P-Tech" futures (which stands for Pacific Stock Exchange Technology Futures Contracts and Options). Eisler also was a floor broker on that exchange. 7 U.S.C. § 1a(16).

Eisler purchased, through his company First West Trading Inc., a number of futures contracts, including P-Tech futures. J.A. 17. Petitioner was Eisler's clearing FCM, thus the contracts were made on behalf of petitioner who was the "buyer or seller of said contract[s]," and petitioner assumed within one hour those contracts on the exchange, *see* NYFE Rule 306(i)(2) (App., *infra*, 14a), and cleared those same contracts with NYCC. Petitioner was responsible to NYCC for the P-Tech futures contract positions. NYCC's rules require as follows:

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[9] The facts set forth in this brief are based on the factual allegations in the complaint because the district court dismissed petitioner's complaint pursuant to Rule 12 of the Federal Rules of Civil Procedure and, therefore, those allegations, *see* J.A. 10-28, must be taken as true.

> If and to the extent a monetary default relates to a Contract carried in the customer account of a Defaulting Clearing Member, such margin, Guarantee Fund deposit and other assets (whether held for the proprietary account or the customer account) shall be applied to pay the Defaulted Obligation.

NYCC By-Law 5.5(a) (J.A. 131-132).

Unbeknownst to petitioner at the time, Eisler was using his position as a member of NYFE's settlement committee to fraudulently set the settlement prices of P-Tech futures from approximately August 1999 through May 12, 2000. He did so in a manner that ensured that his company's positions artificially appeared profitable, even when it was suffering losses on the market, so that it could avoid margin calls. When Eisler was unavailable to set the settlement price on any given day, another member of respondent NYFE's settlement committee would do so "according to instructions left by Eisler, or by using the procedures followed by Eisler." *Matter of Norman Eisler*, CFTC No. 01-14, at 4 (C.F.T.C. Jan. 20, 2004), *available at* http://www.cftc.gov/files/enf/04orders/enfeisler-order.pdf (last visited July 13, 2007).[10]

The CFTC has determined that this deliberate miscalculation, by Eisler and others at his direction, falsely inflated the value of the P-Tech futures positions held by petitioner with NYCC, and by Eisler with petitioner, by approximately $2 million each day. *Id.* at 2, 5. The CFTC also found that NYFE failed to enforce NYFE Rule 315, governing the setting of settlement prices, in violation of the CEA. *Matter of New York Futures Exch.*,

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[10] NYFE settlement prices were generally set using a NYBOT computer system, in which "[a] NYBOT employee was responsible for entering the data into the system and checking the accuracy of the results." *Id.* at 3; *see also* J.A. 18 (alleging that "all responsibility for supervision, regulation, investigation and certain quasi-governmental duties of the NYFE were delegated to NYBOT and NYBOT assumed such duties and responsibilities").

*Inc.*, CFTC No. 01-13 (C.F.T.C. July 11, 2001), *available at* http://www.cftc.gov/files/enf/01orders/enfnyfe.pdf (last visited July 13, 2007).

Petitioner did not know that Eisler was manipulating the settlement prices of P-Tech futures contracts. Petitioner therefore did not know that the positions in its account with NYCC were really losses, not gains, because these losses were masked by NYFE's fraudulently set settlement prices. J.A. 18. That bogus price, in turn, led petitioner to calculate a margin requirement for First West's account with petitioner that was not in line with the economic reality or risk of the value of P-Tech futures contracts. *Ibid.*

By March 2000, respondents received complaints from some members that the P-Tech futures contracts settlement price calculated by Eisler was incorrect. *Id.* at 18-19. But respondents did not investigate or take corrective action. *Id.* at 20.

Eisler began to lose the ability to fraudulently set the P-Tech futures settlement prices by May 2000, when the market for such contracts became too volatile. *Matter of Norman Eisler*, *supra*, at 6. On May 11, 2000, petitioner Klein & Co. Futures was subject to a margin call for NYCC based on the P-Tech futures positions it was responsible for with NYCC due to Eisler, and petitioner met this obligation. J.A. 21-23. Petitioner, in turn, computed a $700,000 margin call on Eisler's First West account, and ordered Eisler to either deposit more funds with petitioner or liquidate his position. *Id.* at 21.

On Friday, May 12, 2000, after Eisler indicated that he could not liquidate his P-Tech positions, *id.* at 22, petitioner requested that respondents take emergency action and suspend trading of P-Tech futures and liquidate all positions at the previous day's settlement price. *Id.* at 23. Respondents refused to do so, explaining that because petitioner had met its margin with NYCC no such emergency action was required. *Ibid.*

On Monday, May 15, 2000, however, Eisler's membership and privileges with respondent NYBOT and

its affiliates, including NYFE and NYCC, were terminated, *id.* at 24, so he could no longer calculate the settlement price for P-Tech futures. *Ibid.* A correct calculation of the P-Tech futures settlement price occurred and petitioner's positions with NYCC in the P-Tech futures market due to Eisler's trades were subject to a margin deficit of $4.5 million. *Id.* at 25.

Eisler was not able to meet the margin call with petitioner to offset that deficit. Petitioner was not able to meet its margin call from NYCC, which meant that petitioner no longer met the minimum capital requirement for membership on NYBOT, NYCE, NYFE and NYCC. *Ibid.* This led to the suspension of petitioner's membership privileges, and the closing of petitioner's business that very day. *Id.* at 26, 28.

### D. Proceedings Below

1. Petitioner brought the instant action on July 26, 2000, in the United States District Court for the Southern District of New York, under, *inter alia*, the Commodity Exchange Act, 7 U.S.C. § 25 (1994), against Eisler, First West, and the several respondents and their officers, directors or committee members. J.A. 9-57.

The district court dismissed the case, holding that petitioner lacked standing. Pet. App. 24a. The district court stated that Section 25 "provides that private remedies are available only to litigants who 'engaged in any transaction on or subject to the rules' of such contract market or licensed boards of trade." *Id.* at 23a (quoting 7 U.S.C. § 25(b)(1)-(3)). The district court interpreted that provision "to mean that only *purchasers or sellers* on the contract market have a right of action" under 7 U.S.C. § 25. *Id.* at 23a-24a (emphasis in original). The court thus concluded that petitioner lacked standing because it was

not a "purchaser or seller" and did not "trade on its own account." *Id.* at 24a.[11]

2. The court of appeals affirmed. Unlike the district court, the court of appeals purported to recognize that 7 U.S.C. § 25 creates different private rights of action against different defendants, but it ignored the differences between the distinct types of actions arising under Section 25(a)(1), (b)(1), (b)(2), and (b)(3). *See* Pet. App. 7a (describing Section 25 as "includ[ing] *two* types of claims") (emphasis added).

The court of appeals held as a general matter that Section 25(a) and (b) "require[] that a putative plaintiff fall within one of the four required relationships set forth in" the various subparagraphs of the (a)(1) cause of action, 7 U.S.C. § 25(a)(1)(A) to (D) (1994). Pet. App. 7a-8a. And, in the court of appeals' view, the "common thread" of the subparagraphs of Section 25(a)(1) "is that they limit claims to those of a plaintiff who actually traded in the commodities market." *Id.* at 8a. The court of appeals concluded that petitioner did not fall within the requirements of Section 25(a)(1)(A) to (D), and thus could not bring any of its claims, including under Section 25(b)(1), because petitioner had not "purchased or sold" P-Tech futures contracts. *Id.* at 9a.

The court of appeals denied a petition for rehearing and rehearing *en banc* on November 14, 2006. *Id.* at 35a-36a.

## SUMMARY OF ARGUMENT

### I.

The plain language of the Commodity Exchange Act confers statutory standing on petitioner to bring this private right of action against respondents. Petitioner falls

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[11] The district court characterized petitioner's obligation to NYCC as "inherited from First West," Pet. App. 21a, revealing the district court's mistaken view that First West could be a counterparty to a clearinghouse in a futures transaction, when in fact only a clearing member can hold such a position. *See, infra*, pages 37-41.

well within the requirement that it have "engaged in any transaction on or subject to the rules" of a commodity futures exchange or its clearinghouse, as required to bring an action under 7 U.S.C. § 25(b)(1) (1994).

A. Petitioner engaged in numerous transactions that were conducted both *on* the exchange and its clearinghouse and *subject to their rules*. With respect to each futures contract trade, respondents' rules required that petitioner "shall be the buyer or seller of said contract" and shall assume that contract on the exchange as its own within one hour of the trade, NYFE Rule 306(i)(2) (App., *infra*, 14a), and petitioner cleared – *i.e.*, consummated – that same contract with NYCC, subject to such rules. NYCC By-Law 5.1 (J.A. 119-120).

B. The court of appeals ignored the significance of petitioner's integral role in these transactions, any one of which confers standing on petitioner under Section 25(b)(1). The court limited standing to those who "purchased or sold" futures contracts. But this ruling disregards petitioner's position as buyer or seller of the contract and is replete with error, contrary to a number of basic statutory tenets, including that the interpretation of a statute must begin with the words of the statute.

The plain text of Section 25(b)(1) and of its neighboring statutory provisions demonstrate that "any transaction on or subject to the rules" of the exchange and clearinghouse necessarily includes the transactions in which petitioner engaged. Had Congress meant to limit standing under Section 25(b)(1) to a subset of futures transactions, *i.e.*, purchases or sales of futures contracts, it would not have used the term "any" transaction – an expansive term not readily subject to such a limitation. *United States v. Gonzales*, 520 U.S. 1, 5 (1997).

Moreover, if Congress had intended to limit the remedy under Section 25(b)(1) to purchasers and sellers, it knew how to do so. In Section 25(a)(1)(D), Congress limited standing to persons only so long as they had "purchased or sold a contract" in certain circumstances.

7 U.S.C. § 25(a)(1)(D) (1994). Congress did not use such terminology in Section 25(b)(1).

The court of appeals also erred when it held that, as a general matter, plaintiffs under the various causes of action in Section 25(b) must have engaged in a transaction that fell within Section 25(a). There is no such cross-reference in Section 25(b)(1). And the cross-references to Section 25(a) in Sections 25(b)(2) and (b)(3) demonstrate that the absence of the cross-reference in Section 25(b)(1) was not inadvertent.

Section 25(b)(3), in particular, highlights that the requirement of Section 25(b)(1) that a plaintiff have engaged in "any transaction on or subject to the rules" of an exchange or clearinghouse is different from the requirement of Section 25(a) that a plaintiff have engaged in one of the transactions specified in Section 25(a)(1)(A) to (D). In Section 25(b)(3), Congress specified that certain suits are available only to persons that satisfy *both* the requirements. Thus, the former requirement cannot be read to mean the same as the latter.

C. The structure of the statute further establishes that "any transaction on or subject to the rules" of an exchange or clearinghouse encompasses petitioner's transactions at issue here. Indeed, 7 U.S.C. § 6(a) *mandated* that the clearing transactions be on or subject to the rules of the exchange and clearinghouse. Section 6(a) provided that the clearing transactions such as those in which petitioner engaged would have been unlawful unless conducted on or subject to the rules of the exchange and clearinghouse. Section 6(a) also uses "any transaction" as a term that is broader than just a purchase or sale contract, which cannot be squared with the court of appeals' statutory interpretation.

## II.

A. The court of appeals' ruling was grounded in the view that trading in commodity futures contracts is nothing more than a contract of sale between a buyer of a futures contract and the seller. It thus held that petitioner was no more than a creditor of its customer. But that

cannot be reconciled with the reality or rules of the exchange which make clear that it is petitioner as the clearing FCM who is the "buyer or seller of said contract" and assumed that contract as its own on the exchange, *see* NYFE Rule 306(i)(2) (App., *infra*, 14a), and then was financially liable to the clearinghouse for the clearing of that same contract. NYCC By-Law 5.5 (J.A. 131-132).

B. Indeed, far from being a mere creditor, an FCM is an indispensable party to a contract on the commodity futures exchange. Every trade must be consummated on the exchange's clearinghouse. Through those transactions, the clearinghouse becomes the buyer to the selling FCM and the seller to the buying FCM and serves the clearinghouse function of eliminating counterparty risk. Clearinghouses transact – *i.e.*, clear – only with their own members. Thus, only a clearing member like a clearing FCM may consummate the trade on the clearinghouse. NYCC By-Law 5.1 (J.A. 119).

## III.

Both Congress and this Court have long recognized that the private rights of action under the Commodity Exchange Act enhance the public enforcement mechanisms. Congress explained "that the right of an aggrieved person to sue a violator of the Act is critical to protecting the public and fundamental to maintaining the creditability of the futures market." H.R. Rep. No. 97-565(I), at 56-57 (1982). Permitting FCMs like petitioner to bring an action against an exchange and its clearinghouse for violation of their obligation to enforce their rules consistent with the Act certainly serves such a public purpose and helps to ensure the integrity of the futures commodity market.

## ARGUMENT

### I. THE PLAIN TEXT AND STRUCTURE OF THE COMMODITY EXCHANGE ACT DEMONSTRATE THAT PETITIONER HAS A CAUSE OF ACTION AGAINST RESPONDENTS UNDER 7 U.S.C. § 25(b)(1)

#### A. Petitioner Is A "Person Who Engaged In Any Transaction On Or Subject To The Rules Of" The Exchange And Clearinghouse

Petitioner has statutory standing because it falls well within the class of plaintiffs vested with a cause of action under Section 25(b)(1). That provision permits "a person who engaged in any transaction on or subject to the rules of" an exchange or its clearinghouse to recover from the exchange or clearinghouse any "actual losses" resulting from that transaction, if the damages were "caused by" the exchange or clearing organization's "failure to enforce * * * bylaws, rules, regulations, or resolutions." 7 U.S.C. § 25(b)(1) (1994).

Petitioner, as an FCM, engaged in a number of transactions "on or subject to the rules of" NYFE and its clearinghouse, NYCC.

Petitioner was the buyer or seller of Eisler's P-Tech futures contracts at issue in the instant dispute, and was required to accept and assume those same contracts "*on*" the exchange, as set forth in Section 25(b)(1). NYFE Rules explicitly require that:

> Every contract made on the Exchange shall be assumed by a member of the Exchange who is a clearing member of the clearing organization which clears contracts made on the Exchange. Every such contract when made by a trading member shall be made on behalf of a clearing member who shall be the buyer or seller of said contract on the terms set forth therein. The clearing member shall assume said contract in writing within one hour after receipt of a report from the trading member identifying the terms thereof.

NYFE Rule 306(i)(2) (App., *infra*, 14a).

Those transactions were also "*subject to the rules of*" the exchange, as set forth in Section 25(b)(1). *See, e.g., ibid*; NYFE Rule 121(f) (App., *infra*, 10a) (requiring a clearing member such as petitioner to be financially involved in every trade); NYFE Rule 315 (App., *infra*, 14a-15a) (prescribing how the settlement price is calculated for the positions); NYFE Rule 703 (App., *infra*, 15a-18a) (prescribing margin requirements); NYBOT Margin Rule XXX(a) (App., *infra*, 20a) ("[N]o carrying member shall carry an open position in a futures or option contract for an account, unless it collects the original margin required pursuant to the Rules within a reasonable time, except for good cause."). And those are rules that respondents were required to enforce. 7 U.S.C. § 7a(a)(8) (1994).[12]

Also, petitioner engaged in transactions on and subject to the rules of the exchange when, as a member of the exchange's clearinghouse, petitioner cleared those contracts it assumed on the exchange *on* the clearinghouse and *subject to* the rules of the clearinghouse. Through that clearing transaction, petitioner as a clearing FCM became the seller of the futures contracts to the clearinghouse. *See, supra*, pages 7-11 (explaining clearing process); NYCC By-Law 5.1 (J.A. 119) ("Only Clearing members shall be entitled to clear Contracts with the Corporation[.] * * * Each Clearing Member shall have the privilege of clearing with the Corporation all Contracts traded on or subject to the rules of each Exchange of which it is a member or member firm * * *, whether for customer or proprietary account"); NYCC By-Law 5.7 (J.A. 142-143) (proscribing margin).

Furthermore, as part of the open and ongoing position in P-Tech futures, petitioner engaged in transactions subject to the rules of the clearinghouse on a daily basis

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[12] In addition, petitioner has alleged transactions that were "subject to the rules of" respondents NYBOT and NYCE, the parent companies of NYFE and NYCC, which had their own rules and bylaws with which members of their subsidiaries, such as petitioner, were required to comply. J.A. 17-18, 20-21, 25-26.

when petitioner settled its accounts and was required to maintain appropriate margin with NYCC. NYCC Rule 502(c) (J.A. 171) (proscribing variation margin requirements based upon settlement price).

Any one of these transactions was sufficient to confer standing on petitioner under the plain text of 7 U.S.C. § 25(b)(1), as a person who engaged in "any transaction on or subject to the rules of" the exchange or clearinghouse.

### B. Core Principles Of Statutory Construction Demonstrate That Section 25(b)(1) Is Not Limited To Purchasers And Sellers

The court of appeals fundamentally erred by holding that, because petitioner had not purchased or sold the P-Tech futures contracts on its own behalf, petitioner had not met the Section 25(b)(1) requirement that it be a person who "engaged in any transaction on or subject to the rules of" the exchange or its clearinghouse. *See* Pet. App. 8a (court of appeals required plaintiff to have "traded" in the commodities market); *id.* at 9a (court of appeals concluded that petitioner could not meet standing requirement because it failed to "contend that it purchased or sold P-Tech contracts"); *id.* at 11a (court of appeals emphasized that "Klein was not an owner of P-Tech contracts traded by First West").

First, as explained above, that reasoning should not deny petitioner standing because petitioner is the "buyer or seller" of the futures contract that it "assumed" as its own under respondents' own rules. *See* NYFE Rule 306(i)(2) (App., *infra*, 14a). Second, that ruling cannot be squared with the statutory text, and thus the fundamental tenet that any interpretation of a statute must begin with the words of the statute itself, *see, e.g.*, *Estate of Cowart v. Nicklos Drilling Co.*, 505 U.S. 469, 475 (1992), which do not so narrowly limit the persons with standing under Section 25(b)(1) to only the purchaser or seller of a futures contract.

### 1. The term "any transaction" is not limited to a purchase or sale of a contract

Section 25(b)(1) confers standing on a person who engaged in "*any* transaction" on or subject to exchange or clearinghouse rules. It is not limited to a person who engaged in a transaction to purchase or sell futures contracts on its own behalf.

The term "any," of course, when "[r]ead naturally, * * * has an expansive meaning, that is, 'one or some indiscriminately of whatever kind.'" *United States v. Gonzales*, 520 U.S. 1, 5 (1997) (quoting *Webster's Third New International Dictionary* 97 (1976)). The only language that Congress added to limit the term "any" as it described "transaction" was that the transaction must have been "on or subject to" the rules of an exchange or clearinghouse. "Any transaction" thus unambiguously encompasses many different types of transactions, in addition to the purchase and sale of contracts, that are involved in commodities futures trading and are subject to such rules. Such transactions include, for example, the transaction between an individual or entity that executes a trade and its clearing FCM which must guarantee and assume the trade, and the transaction between a clearing FCM and the clearinghouse to clear the trade. *See, supra*, pages 24-26.

Reading Section 25(b)(1) consistent with its plain text does not lead to absurd results or "separate the statute from its intended purpose." *Lewis v. United States*, 523 U.S. 155, 159-160 (1998). Section 25(b)(1) does not create boundless liability. Indeed, the requirement that a plaintiff have engaged in an exchange or clearinghouse transaction ensures that only participants in the futures market can bring a suit and not others, even if they might experience economic consequences from a market participant's transactions on the futures market. *See, e.g., American Agri. Movement, Inc. v. Board of Trade of the City of Chicago*, 977 F.2d 1147 (7th Cir. 1992) (holding that farmers who were not participants in the futures market did not have standing under Section 25(b)(1), (3) even

though the exchange's actions with respect to its rules may have affected the price at which they could sell their crops). Congress thereby precluded actions "for speculative damages to assets that are affected by fluctuations in prices on the commodity market but which are not the subject of transactions on such market." H.R. Rep. No. 97-565(I), at 57 (1982).

Moreover, Congress further limited the scope of Section 25(b)(1) to actions for "actual losses," and to require, in actions against exchanges and clearinghouses, that the plaintiff prove bad faith. *See* 7 U.S.C. § 25(b)(1), (4) (1994).

### 2. Congress limited a different cause of action to purchasers and sellers

If Congress had intended to limit liability under Section 25(b)(1) to purchasers and sellers of futures contracts, it knew how to do so. That is evident because Congress did so in Section 25(a)(1)(D).

Section 25(a)(1)(D) identifies one of the categories of plaintiffs who have standing to bring suit under Section 25(a)(1) against FCMs, floor brokers, or other persons or firms who are not an exchange or its clearinghouse. Congress specified that, in circumstances where the violation constitutes price manipulation, suit could be brought only by a person who "purchased or sold a contract." 7 U.S.C. § 25(a)(1)(D) (1994).

Congress obviously chose not to use that language in Section 25(b)(1) and did not so limit standing when it authorized actions against exchanges and their clearinghouses.

### 3. Section 25(b)(1) does not incorporate the limits of Section 25(a)

The court of appeals also erred when it held that, as a general matter, plaintiffs under the various causes of action in Section 25(b) must have engaged in a transaction that fell within Section 25(a). Pet. App. 7a-8a ("[t]he text of

[subdivisions 25(a) and 25(b)] requires that a putative plaintiff fall within one of the four required relationships set forth in § 2[5](a)(1)(A-D)").

There is no such cross-reference anywhere in the text of Section 25(b)(1). Congress's failure to so limit Section 25(b)(1) is all the more obvious because Congress did limit Section 25(b)(2) and (b)(3). Both Section 25(b)(2) and (b)(3) provide that only a person who engaged in "any transaction specified in subsection (a)" can bring suit. The incorporation of that provision in Sections 25(b)(2) and (b)(3) demonstrates that its omission in the adjacent Section 25(b)(1) was not inadvertent.

Moreover, Section 25(b)(3) firmly establishes that Section 25(b)(1)'s reference to a person who engaged in "any transaction on or subject to the rules of" an exchange or clearinghouse cannot be read, as the court of appeals apparently did, to mean a person who engaged in a transaction specified in Section 25(a). Section 25(b)(3) grants standing under one prong of that provision only to a person who satisfies *both* the requirement that he have engaged in a transaction specified in Section 25(a), and *also* that that transaction have been "on, or subject to the rules of" a contract market, clearinghouse, or board of trade. 7 U.S.C. § 25(b)(3) (1994).

Certainly the fact that Section 25(b)(3) includes both requirements demonstrates that Congress did not intend that the two requirements be read to mean the exact same thing. Yet, that is, in essence, what the court of appeals did. It thereby rendered superfluous parts of Section 25(b)(3) because, according to the court, the requirement that the transaction have been "on, or subject to, the rules of" the exchange or clearinghouse means nothing more than the other requirement that the transaction have been one that is specified in Section 25(a).

The court of appeals' circular reasoning violates a number of core principles of statutory construction. It violates the basic canon that, "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally

presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23 (1983) (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)); *see also Lopez v. Gonzales*, 127 S. Ct. 625, 631 (2006); *Barnhardt v. Sigmon Coal Co., Inc.*, 534 U.S. 438, 454 (2002); *INS v. Cardoza-Fonseca*, 480 U.S. 421, 431 (1987).[13]

The court of appeals' ruling also runs contrary to the well understood fact that if phrases are to have the same meaning, "it would have been natural for Congress to write in like terms." *Johnson v. United States*, 529 U.S. 694, 704-705 (2000). And it cannot be reconciled with the "'cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001)) (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (2001)).

### 4. The different standing requirements in Section 25(a) and 25(b)(1) reflect different types of private suits intended by Congress

Congress's imposition of different standing requirements for suits against different defendants under the various causes of action in Section 25 reflects the different purposes of those causes of action.

Suits brought under Section 25(a) are customer-driven lawsuits against the entities with whom futures customers conduct business – *e.g.*, FCMs. By contrast, it is not just

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[13] Indeed, with respect to this *very* provision, this Court previously has refused to incorporate provisions that exist elsewhere in the statute but were omitted from 7 U.S.C. § 25. *Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co.*, 484 U.S. 97, 106 (1987) (explaining that because "Congress expressly provided for nationwide service of process" in other CEA enforcement provisions, "[i]t would appear that Congress knows how to authorize nationwide service of process when it wants to provide for it" and "[t]hat Congress failed to do so here argues forcefully that such authorization was not its intention").

customers who would bring suits under Section 25(b)(1) against exchanges and their clearinghouses regarding their erroneous enforcement, or failure to enforce, their rules and regulations. In such instances, the entities that deal with the exchanges and clearinghouses and are subject to their rules and regulations, *i.e.*, the FCMs, have an economic interest and sophistication to bring such suits. Indeed, clearing FCMs financially guarantee all customer trades to the clearinghouse and therefore are susceptible to greater losses than any one customer if an exchange or clearinghouse fails to enforce its rules that ensure the integrity of the futures market. Congress thus authorized FCMs to sue an exchange or clearinghouse that causes them actual losses, in bad faith.

Moreover, it would make little sense to limit standing under Section 25(b)(1) to persons engaged in the customer-based transactions listed in Section 25(a)(1) because customers have no direct relationship with the exchanges and clearinghouses subject to suit under Section 25(b)(1).[14]

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[14] None of this is to say that customers of FCMs lack standing under Section 25(b)(1), even though they are prohibited by Congress, the CFTC, and respondents' own rules from engaging directly in transactions *on* the exchange and are not known to the clearinghouse. This is because the Section 25(b)(1) cause of action is also granted to any person who engages in a transaction "subject to the rules of" the exchange. 7 U.S.C. § 25(b)(1) (1994). An FCM's dealings with its customers is subject to many of respondents' rules, *see, e.g.*, NYFE Rule 305 (App., *infra*, 10a-11a) (prohibiting a member from taking the opposite position of a customer's order), so that if an exchange were to fail to enforce those rules, to the detriment of the FCM customer, that customer also has an action under Section 25(b)(1) against the exchange or its clearinghouse for bad faith, actual losses. Thus, customers who are injured by a market manipulation that the exchange has failed, in bad faith, to prevent or stop likewise would have a cause of action against the exchange, just as this Court held in *Curran*.

### C. The Structure Of The CEA Confirms That Congress Understood The Transactions By Petitioner To Be "On Or Subject To The Rules Of" The Exchange And Clearinghouse

The framework created by Congress in the CEA for the trading of commodity futures contracts requires that the transactions in which petitioner engaged be on or subject to the rules of an exchange and its clearinghouse.

#### 1. 7 U.S.C. § 6(a)(1) *requires* that transactions in which clearing FCMs engage be on, or subject to, the rules of an exchange and its clearinghouse

Section 6(a) states, in relevant part, that it is unlawful for a person to "enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States * * * for the purpose of * * * dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery * * * unless –

> (1) such transaction is *conducted on or subject to the rules of* a board of trade which has been designated by the Commission as a "contract market" for such commodity;
>
> (2) such contract is executed or consummated by or through a member of such contract market; and
>
> (3) such contract is evidenced by a record in writing * * *."

7 U.S.C. § 6(a) (1994) (emphasis added).

The transactions enumerated in Section 6(a) include precisely the types of transactions in which Congress has authorized clearing FCMs to engage. For example, petitioner's assumption of the futures contracts at issue here on the exchange and its clearing of those trades, pursuant to NYFE Rule 306(i)(2) and NYCC By-Law 5.1, fall squarely within Section 6(a) as the conduct of business for the purpose of dealing in a transaction "in, or in

connection with, a contract for the purchase or sale of a commodity for future delivery." Thus, Section 6(a)(1) required that petitioner's transactions be conducted on or subject to the rules of the exchange and clearinghouse in order to be lawful.

Of course, the transactions in which petitioner engaged here are typical of every clearing transaction that consummates every commodity futures contract trade. And to hold that petitioner did not engage in a transaction on or subject to the rules of the exchange under Section 25(b)(1) would mean that the transactions in which clearing FCMs always engage to consummate futures contracts are unlawful under Section 6(a).

Such a ruling would render superfluous other provisions of the statute. For example Section 6(a)(2) requires that a commodity futures contract be "executed or consummated by or through a member of such contract market." Under the rules of the exchange and clearinghouse, the only entity that can consummate a contract is a member of the exchange's clearinghouse like a clearing FCM. *See* NYCC By-Law 5.1 (J.A. 119). Therefore, if an FCM's consummation of a trade is unlawful, Section 6(a)(2)'s provision for consummation of a trade through a clearing FCM is left with no application. Congress plainly did not contemplate such a result, requiring reversal of the ruling below. *TRW Inc.*, 534 U.S. at 31 (2001).

### 2. 7 U.S.C. § 6(a)(2), (3) confirm that "any transaction" is broader than a purchase or sale contract

Section 6(a) refers at the outset to "*any transaction*" that is "in, or in connection with, a *contract for the purchase or sale* of a commodity for future delivery." Section 6(a)(1) then talks in terms of "such transaction," but Sections 6(a)(2) and (3) talk in terms of "such contract." This statutory text and structure thus confirm that Congress used the terms differently and intended

that "any transaction" in the CEA be broader than only the purchase and sale of a commodity futures contract.

The court of appeals, however, ignored the distinction between "any transaction" and a "contract for the purchase or sale of a commodity for future delivery," contrary to well-settled understanding that if Congress considered terms to have the same meaning, Congress would not have used different terms for each. *See Johnson v. United States*, 529 U.S. 694, 704-705 (2000) (explaining that if the phrases were to have the same meaning, "it would have been natural for Congress to write in like terms. * * * But that is not what Congress did."); *Smith v. United States*, 508 U.S. 223, 235-236 (1993) (explaining that Congress "carefully varied the statutory language" so that "with respect to some crimes, the firearm is subject to forfeiture not only if it is 'used,' but also if it is 'involved in' the offense").

## II. RESPONDENTS' RULES, THE CEA, AND CFTC REGULATIONS ARE ROOTED IN THE UNDERSTANDING THAT FCMS LIKE PETITIONER ARE PRINCIPALS TO TRANSACTIONS ON OR SUBJECT TO THE RULES OF THE EXCHANGE AND ITS CLEARINGHOUSE

In denying petitioner standing, the court of appeals concluded that petitioner's "loss was a credit loss, not a trading loss" so that, in the court's view, petitioner's injury did not result from a transaction on or subject to the rules of the exchange or its clearinghouse. Pet. App. 12a. The court of appeals thus treated a futures transaction as no more than a contract of sale between the buyer of a futures contract and that contract's seller, with the clearing FCM of the buyer or seller nothing more than an extender of credit to that customer. *Id.* at 11a.

Putting aside the fact that the difference between a credit loss and a trading loss is irrelevant to determining whether a person "engaged in a transaction on or subject to the rules of" an exchange or clearinghouse, the court of appeals' view is wrong under respondents' own rules and

by-laws, as well as the CEA and the CFTC's implementing regulations.

Petitioner, in fact and in law, was a principal to the P-Tech futures contracts of Eisler on the exchange and it necessarily engaged in the transactions to consummate those contracts on the clearinghouse.

### A. Clearing FCMs Are Not Mere Creditors Because They Are The Buyer Or Seller Of The Futures Contract And Assume As Their Own That Contract On The Exchange

At the outset, by describing petitioner as no more than a creditor of First West, the court of appeals mistakenly assumed that that entity traded on the exchange with another customer on the exchange. That is not the case.

Since the founding of the Chicago Board of Trade in 1848, only members of the exchange can lawfully conduct business – *i.e.*, trade – on the exchange. *See Board of Trade of the City of Chicago v. Christie Grain & Stock Co.*, 198 U.S. 236, 248 (1905) ("the contracts made in the pits are contracts between the members"). That was, and remains, true for trades occurring on respondent NYBOT's subsidiary exchanges, including NYFE and NYCE, because respondents' floor trading rules expressly concede that only members with floor trading privileges have access to the trading floor. *See* NYBOT Rule 4.02, *available at* http://www.nybot.com/aboutNYBOT/rulebooks/nybot/download/Ch%2027%20Electronic%20Trading%20Rules.pdf (last visited July 18, 2007); *see also* NYFE Rule 121(f) (App., *infra*, 10a) (requiring a clearing member such as petitioner to be part of the transaction).

Moreover, respondents' rules dictate that a clearing FCM is a necessary *party* in every commodity futures contract executed on the exchange. As previously discussed, *see, supra,* pages 24-26, NYFE Rule 306(i)(2) required petitioner, as a clearing member, to be the buyer or seller on whose behalf the contract is made and to

assume the futures contracts on the exchange. NYFE Rule 306(i)(2) (App., *infra*, 14a).

These rules are not advisory. As demonstrated above in the discussion of 7 U.S.C. § 6(a), Congress has mandated that members of an exchange must "execute[] or consummate[]" a futures contract for it to be lawful. That mandate precludes the direct buyer-to-seller contractual relationship between the investors that the court below erroneously envisioned. 7 U.S.C. § 6(a)(2) (1994); *see also Ricci v. Chicago Mercantile Exch.*, 409 U.S. 289, 303 (1973) ("[T]he express will of Congress is that to deal in commodity futures one must either be, or deal through, a member of a board of trade having specified qualifications and carrying official designation as a contract market."); 17 C.F.R. § 1.3(q) (1999) (defining "member" of an exchange to be a person with "trading privileges" on the exchange).

The rules and bylaws restricting trading to exchange members are among those that respondents are required to enforce by virtue of the CEA. 7 U.S.C. § 7a(a)(8) (1994).

### B. Clearing FCMs Necessarily Engage In Transactions Subject To Clearinghouse Rules Because Only Such Clearing Members Can Perform The Required Consummation Of A Trade On The Clearinghouse And They Become Financially Liable For The Same

The court of appeals' creditor theory further falters with respect to transactions on the exchange's clearinghouse. Far from being a creditor, the clearing FCM takes on the financial liability to the clearinghouse of the trade and that remains regardless of the customer's obligation to the FCM. Indeed, it is only a member of the clearinghouse like a clearing FCM, not a buyer or seller, who can engage in the required transaction to consummate a trade on the clearinghouse.

1. As discussed above, there is no contractual relationship formed between two customers who arrange

for members of the exchange to trade on their behalf. Even if such a contractual relation were to exist, however, it would be severed when the clearing FCMs assume the contracts and clear them.

The process of clearing substitutes the clearinghouse as the buyer to the selling FCM and the seller to the buying FCM. *See*, *supra*, pages 7-11 (detailing operation of clearing transactions). Respondent NYCC acknowledges this fact. App., *infra*, 19a; *see also* CME Clearing at 2 (explaining that CME Clearing deals exclusively with its members and "does not look to individual customers for performance").

Accordingly, the underlying financial obligations in the trade that was executed on the floor of the exchange become the obligations of the clearing FCM on one side of the agreement and the clearinghouse on the other side of the agreement. *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2380 n.8 (1976) (Statement of CFTC Chairman William T. Bagley) ("the clearing house is substituted into each contract * * * through a contractual agreement"; this involves the "simultaneous assignment of rights and delegation of duties under the contract to the clearing house by both parties to the contract upon its acceptance by a clearing house for clearance.").

In sum, the clearing FCM, not the exchange member that executed the contract nor its underlying customer, is the counterparty to the clearinghouse in the clearing transaction that consummates the contract.

2. Clearing FCMs must play this role in commodity futures contract trades because trades must be cleared and only members of the clearinghouse can do so.

The clearing of trades and the use of a clearinghouse are not voluntary. The CFTC has long-explained that "the essence of the integrity" of an exchange is the clearinghouse. The existence of a clearinghouse "is a necessary prerequisite to receiving and retaining designation as a contract market." 41 Fed. Reg. 40,091, 40,093 (Sept. 17, 1976); *see*

*also ibid.* (a futures contract not cleared "would be 'contrary to the public interest' ").[15]

This construction by the CFTC of the CEA "must be accorded" "considerable weight." *CFTC v. Schor*, 478 U.S. 833, 844-845 (1986) (citing *Chevron U.S.A. Inc. v. Nat. Res. Defense Council, Inc.*, 467 U.S. 837, 844-845 (1984)).[16] And, not surprisingly, the rules of respondent NYCC are in accord with this federal mandate: "Only Clearing members shall be entitled to clear Contracts with the Corporation[.] * * * Each Clearing Member shall have the privilege of clearing with the Corporation all Contracts traded on or subject to the rules of each Exchange of which it is a member or member firm * * *, whether for customer or proprietary account." NYCC By-Law 5.1 (J.A. 119).

3. The reality of the contractual obligations of the parties involved confirm that a clearing FCM is financially liable for and a party to the underlying commodity futures contract transaction.

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[15] Until the decision below, the courts of appeals where the major exchanges are located had long-recognized this well-established and required practice of commodity trading. *See, e.g., Bosco v. Serhant*, 836 F.2d 271, 273 (7th Cir. 1987), *cert. denied*, 486 U.S. 1056 (1988) (noting that a futures transaction cannot occur without the "services of both a clearing member of the Exchange * * * and a futures commission merchant"); *Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179, 181 (7th Cir. 1984) (Posner, J.); (explaining that only clearing members can enter into contracts, thereby insuring that the contract will go through); *Leist v. Simplot*, 638 F.2d 283, 287 (2d Cir. 1980) (Friendly, J.), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982) ("the clearing house treats FCMs as principals in trading transactions").

[16] The CFTC defines a "clearing member" such as petitioner as "any person who is a member of, or enjoys the privilege of clearing trades in his own name through, the clearing organization of a contract market." 17 C.F.R. § 1.3(c) (1999). And in defining a "clearing organization," the CFTC explains that a clearinghouse acts as a medium for "clearing transactions in commodities for future delivery * * * or for effecting settlements of contracts for future delivery * * *, for and between *members* of any contract market." *Id.* § 1.3(d) (1999) (emphasis added).

The submission and acceptance of a futures contract for clearing by a clearing FCM to the clearinghouse dictates that any losses arise not from the extension of any credit, but due to the contractual obligations in which the *clearing FCM* is bound to the clearinghouse. The CFTC has explained:

> [W]hile the clearing house recognizes the rights of commodity customers, it deals only with its clearing members. The actual contractual situation is much more complex. The clearing house is contractually bound to clearing members, not the customers on whose behalf clearing members present trades for clearing. The clearing member, not the clearing house, is contractually bound to its customers.

Bankruptcy Hearings at 2380 n.8.

Accordingly, when a default occurs in a clearing FCM's account with a clearinghouse, the clearinghouse may satisfy that default by taking from the FCM any funds in the account, including those *unrelated to* the actual futures contract(s) that led to the default. *See* CFTC, *Interpretive Statement No. 85-3*, Comm. Fut. L. Rep. ¶ 22,703, 30,987-30,988 (OGC Aug. 12, 1985) ("a clearinghouse deals only with its clearing members and thus does not know the specific customer on whose behalf a particular contract was entered into by one of its clearing members.") (*quoting* Bankruptcy Hearings at 2395).

The CFTC understands that, although an FCM is prohibited from using its customer's funds to satisfy other obligations, *see* 17 C.F.R. § 1.22 (1999), that prohibition does not extend to a clearinghouse. A clearinghouse can look to all of the funds in the FCM's account with the clearinghouse to satisfy the FCM's obligation to it. The clearinghouse does not treat the FCM's customer funds "as the property of the particular customers of the clearing member firm to whom they may ultimately be traceable." CFTC, *Segregation of Customer Funds*, 50 Fed. Reg. 36,049, 36,050 (Sept. 5, 1985) (to be codified at 17 C.F.R. pt. 1) (explaining technical amendment to 17 C.F.R.

§ 1.20(a)); *see also ibid* (clearinghouse's customers are its members). "[A] clearing house deals strictly with its clearing members," not with individual investors, "in a relationship well-defined by the exchange's or the clearing house's rule book." Bankruptcy Hearings at 2409.

Respondents' rules, which govern petitioner's clearing transactions at issue here, require that clearing FCMs be held liable in this manner. For example, respondent NYCC By-Law 5.5(a) states: "If and to the extent a monetary default relates to a Contract carried in the customer account of a Defaulting Clearing Member, such margin, Guarantee Fund deposit and other assets (whether held for the proprietary account or the customer account) shall be applied to pay the Defaulted Obligation." *See* J.A. 131-132. Moreover, if the clearing member lacks the funds to meet the defaulted obligation, "such Defaulting Clearing Member shall continue to be liable therefor[e]." NYCC By-Law 5.5(b) (J.A. 132).[17]

As such, when Eisler's manipulation was brought to light, respondents never even sought to satisfy the unmet margin obligations to NYCC in P-Tech futures from Eisler or First West. Instead, consistent with the exchange rules that governed the clearing transactions in which petitioner had engaged, respondents looked only to petitioner, as the counterparty to NYCC for those contracts.

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[17] The absence of any contractual relationship between an FCM customer and the clearinghouse is underscored by respondent NYCC's Rule 802. Upon suspension of a clearing member of the exchange, all the open futures contracts are liquidated unless they are transferred and accepted by another clearing member. J.A. 191. This liquidation can occur even if the open contract is fully margined and the FCM customer wants to maintain the position.

## III. CONGRESS INTENDED FOR PRIVATE RIGHTS OF ACTION, INCLUDING UNDER SECTION 25, TO SERVE AS IMPORTANT ENFORCEMENT MECHANISMS UNDER THE CEA

The background and history of 7 U.S.C. § 25 demonstrate that Congress intended for FCMs to possess a private right of action against exchanges and clearinghouses, as an important enforcement tool in the regulation of the commodity futures industry.

This Court has long recognized that a "private cause of action enhances the enforcement mechanism fostered by Congress over the course of 60 years." *Curran*, 456 U.S. at 387. Congress's decision to "strengthen the regulation of commodity futures trading" was not intended to eliminate private causes of action; rather, "Congress evidenced an affirmative intent to preserve this enforcement tool." *Ibid.*

Section 25 was enacted against the backdrop of this Court's *Curran* decision. Congress began consideration of the statutory cause of action before this Court had issued its decision in the case. H.R. Rep. No. 97-565(I), at 56 (1982) ("At the time the Committee considered the bill, the Supreme Court had not yet resolved the issue of whether a private right of action could be implied under the Act."). It was during that legislative consideration that the Court ruled in *Curran* that the private right of action that had been recognized by the lower federal courts since 1967 survived the 1974 amendments to the CEA. 456 U.S. at 388. And it was established at that time that the implied private right of action included FCMs as plaintiffs. *See, e.g., Seligson v. New York Produce Exch.*, 378 F. Supp. 1076, 1084 (S.D.N.Y. 1974) ("brokers as well as customers suffer when an orderly market is not maintained. * * * [P]laintiff [futures commission merchant] has as great a right to be protected by maintaining this action as would a customer").

Indeed, one of the consolidated cases before the Court in *Curran* involved a suit by an FCM against an exchange. *See Leist v. Simplot*, 638 F.2d 283, 285 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v.*

*Curran*, 456 U.S. 353 (1982). In *Leist*, an FCM was among the plaintiffs that alleged it suffered losses for transactions conducted on the exchange after the exchange acted in concert with others to manipulate the potato futures market in violation of the CEA, and that the exchange failed to follow its own rules that would have prevented the market manipulation. *Leist*, 638 F.2d at 292. In permitting the cause to go forward, the court of appeals found no reason to preclude it merely because it was filed by a member of an exchange rather than one of the member's customers. *Id.* at 300-301. By affirming this decision, this Court recognized that "Congress viewed [such] private litigation against exchanges as a valuable component of the self-regulation concept." *Curran*, 456 U.S. at 385.

When Congress enacted 7 U.S.C. § 25(b)(1), shortly after *Curran*, it did not diverge significantly from the pre-existing implied private rights of action. As demonstrated above, the text of the statute makes clear that Section 25(b)(1) vests a broad cause of action against exchanges by a person who engaged in "any transaction" that is conducted "on or subject to the rules of" the exchange or its clearinghouse. *See, supra*, pages 24-34. The limited legislative history surrounding the enactment of Section 25 evinces no intent by Congress to make FCMs ineligible to bring suit, or to disavow the right that they had possessed in the past. If anything, the contrary is true because Congress began its consideration of Section 25 before *Curran* was decided, with the specific intent to codify the private right of action. This intent was consistent with the belief "that the right of an aggrieved person to sue a violator of the Act [was] critical to protecting the public and fundamental to maintaining the creditability of the futures market." H.R. Rep. No. 97-565(I), at 57 (1982). Permitting FCMs such as petitioner to sue wrongdoers such as respondents similarly furthers the public interest in ensuring the integrity of the market.

## CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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# APPENDIX A

The relevant provisions of the Commodity Exchange Act, 7 U.S.C. §§ 6(a), 25 (1994), as in effect when this case was filed on July 26, 2000, provide:

## § 6. Regulation of futures trading and foreign transactions

(a) Restriction of futures trading to contract markets

Unless exempted by the Commission pursuant to subsection (c) of this section, it shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) unless –

(1) such transaction is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a "contract market" for such commodity;

(2) such contract is executed or consummated by or through a member of such contract market; and

(3) such contract is evidenced by a record in writing which shows the date, the parties to such contract and their addresses, the property covered and its price, and the terms of delivery: Provided, That each contract market member shall keep such record for a period of three years from the date thereof, or for a

longer period if the Commission shall so direct, which record shall at all times be open to the inspection of any representative of the Commission or the Department of Justice.

* * *

## § 25. Private rights of action

(a) Actual damages; actionable transactions; exclusive remedy

(1) Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person –

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of –

(i) an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

(2) Except as provided in subsection (b) of this section, the rights of action authorized by this subsection and by sections 7a(11), 18, and 21(b)(10) of this title shall be the exclusive remedies under this chapter available to any person who sustains loss as a result of any alleged violation of this chapter. Nothing in this subsection shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims under this section, including arbitration.

(3) In any action arising from a violation in the execution of an order on the floor of a contract market, the person referred to in paragraph (1) shall be liable for –

(A) actual damages proximately caused by such violation. If an award of actual damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under sections 2, 2a, and 4

of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award; and

(B) where the violation is willful and intentional, punitive or exemplary damages equal to no more than two times the amount of such actual damages. If an award of punitive or exemplary damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under sections 2, 2a, and 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award if the floor broker fails to do so, except that such requirement shall apply to the futures commission merchant only if it willfully and intentionally selected the floor broker with the intent to assist or facilitate the floor broker's violation.

(b) Liabilities of organizations and individuals; bad faith requirement; exclusive remedy

(1)(A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by section 7a(8) and section 7a(9) of this title,

(B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or

(C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution

violates this chapter or any Commission rule, regulation, or order,

shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

(2) A registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title or in enforcing any such bylaw or rule violates this chapter or any Commission rule, regulation, or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule.

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a contract market, clearing organization, licensed board of trade, or a registered futures association willfully aids, abets, counsels, induces, or procures any failure by any such entity to enforce (or any violation of the chapter in enforcing) any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, shall be liable for actual damages sustained by a person who engaged in any transaction specified in subsection (a) of this section on, or subject to the rules of, such contract market, licensed board of trade or, in the case of an officer, director, governor, committee member, or employee of a registered futures association, any transaction specified in subsection (a) of this section, in either case to the extent of

such person's actual losses that resulted from such transaction and were caused by such failure or violation.

(4) A person seeking to enforce liability under this section must establish that the contract market, licensed board of trade, clearing organization, registered futures association, officer, director, governor, committee member, or employee acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss.

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this chapter available to any person who sustains a loss as a result of (A) the alleged failure by a contract market, licensed board of trade, clearing organization, or registered futures association or by any officer, director, governor, committee member, or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution referred to in this subsection that is alleged to have violated this chapter, or any Commission rule, regulation, or order.

(c) Jurisdiction; statute of limitations; venue; process

The United States district courts shall have exclusive jurisdiction of actions brought under this section. Any such action shall be brought not later than two years after the date the cause of action arises. Any action brought under subsection (a) of this section may be brought in any judicial district wherein the defendant is found, resides, or transacts business, or in the judicial district wherein any act or transaction constituting the violation occurs. Process in such action may be served in any judicial

district of which the defendant is an inhabitant or wherever the defendant may be found.

(d) Dates of application to actions

The provisions of this section shall become effective with respect to causes of action accruing on or after the date of enactment of the Futures Trading Act of 1982 [January 11, 1983]: Provided, That the enactment of the Futures Trading Act of 1982 shall not affect any right of any parties which may exist with respect to causes of action accruing prior to such date.

## APPENDIX B

The By-Laws and Rules of the New York Futures Exchange, as in effect when this case was filed on July 26, 2000, provide in relevant part:

Officials of the
New York Futures Exchange, Inc.
4 WORLD TRADE CENTER, 8th Fl.,
NEW YORK, N.Y. 10048
(212) 742-5001
NORMAN EISLER, CHAIRMAN
JOSEPH J. O'NEILL, PRESIDENT
THOMAS J. GREENE, SENIOR VICE PRESIDENT
TERRENCE H. MILLER, VICE PRESIDENT
ANGEL MOTISI, SECRETARY
New York Futures Exchange, Inc.

---

Board of Directors
1999-2000
NORMAN EISLER, CHAIRMAN
DAVID A. BAKER
RICHARD S. DEWLING
WALTER E. FAIR
A. GEORGE GERO
KEITH W. HOCHSTIN
GARY KNAPP
ROBERT LAKE
M. SCOTT MANOLIS
ANTHONY MANORY
ROBERT MARSH
CHRISTOPHER MEEK
ALFRED PERAS
TOM PETERS
THOMAS SANCHEZ
DAVID SCHELHORN
MELISSA SCHRAMM

JEFFREY M. SOMAN
CHARLES SWEENEY
JOHN M. WALSH

* * *

**Trading Members**

**Rule 121** (a) The approval of an applicant shall not qualify said person to execute contracts on the floor of the Exchange unless said person is also approved by the Committee on Membership as a trading member. Each trading member, upon approval as such, shall receive a trading badge with a unique number and/or letter symbol, which badge must be displayed at all times by the trading member when on the trading floor.

(b) No person shall be approved as a trading member who is not registered or licensed with the Commodity Futures Trading Commission as a floor trader or floor broker, and no holder of a membership interest shall act as a floor trader or floor broker, as those terms are defined under the Commodity Exchange Act, without being currently registered or licensed as such.

(c) No person shall be approved as a trading member who has not successfully completed an ethics training course as required by the Commodity Futures Trading Commission. Such ethics training must be under the auspices, or meet the approval, of the Exchange.

(d) No person shall be approved as a trading member who has not demonstrated to the satisfaction of the Committee on Membership the capability of performing the functions of a trading member by reason of floor experience of at least six months and/or successful

completion of an Exchange-authorized floor-trading training program.

(e) No person shall be approved or shall act as a trading member who does not have a net worth (defined herein as an excess of current assets over current liabilities) of at least $20,000, or who does not file with the Exchange a certified financial statement in such form and at such time as the Exchange may request.

(f) No person shall be approved or shall act as a trading member whose obligations on the Exchange are not guaranteed, in such form as may be prescribed by the Committee on Membership, by a clearing member of the Exchange. A guaranteeing clearing member shall be obligated to promptly accept and clear any trades that have been matched trader-to-trader on the Exchange by a trading member with whom the clearing member guarantees, which trades have not been cleared by another clearing member, and, whenever directed by the Exchange, to accept, by transfer or otherwise, any transaction effected by or for the account of such trading member.

(g) Notwithstanding the provisions of subdivision (f), above, an existing qualifying clearing member agreement may be used instead of a guarantee to qualify a member for trading privileges.

* * *

**Trading Against Customer's Order**

**Rule 305** No member (other than a floor broker whose transactions are governed by Rule 306) having an order from a customer may take the opposite side of the transaction for himself, directly or indirectly, or for an

account of any firm or corporation of which he is a partner, officer, or employee, or for account of any partner, officer, or employee of such firm or corporation, unless the member taking the opposite side or the clearing member has on file the prior written consent of the customer. Such consent need not be given for each transaction but may be given in general terms; provided, however, that the customer consent must be evidenced by an instrument separate from any customer's agreement with the clearing member. If the requisite prior consent is so filed, the transaction may be effected in accordance with the Rules of the Exchange, including, but not limited to, Rule 308, notwithstanding the provisions of subparagraph (e) thereof.

Members shall use due diligence to insure compliance with this Rule.

* * *

**Trading Standards for Floor Brokers**

**Rule 306** (a) No floor broker shall purchase any contract (including a purchase of a futures contract, or a purchase of a call or sale of a put on the same future) for his own account, or for any account in which he has an interest, while holding an order of another person for the purchase of the same contract (including a purchase of a futures contract, or a purchase of a call or sale of a put on the same future) which is executable at the market price or at a price at which such purchase can be made for the floor broker's own account or for an account in which he has an interest.

(b) No floor broker shall sell any contract (including a sale of a futures contract, or a sale of a call or purchase of a put on the same future) for his own account, or for any

account in which he has an interest, while holding an order of another person for the sale of the same contract (including a sale of a futures contract, or a sale of a cotton options call or purchase of a put on the same future) which is executable at the market price or at a price at which such sale can be made for the floor broker's own account or for an account in which he has an interest.

(c) No floor broker shall execute any transaction for any account of a customer for which buying and/or selling orders can be placed or originated, or for which transactions can be executed by such floor broker, without the prior specific consent of the customer (hereinafter referred to as "discretionary orders") regardless of whether the general authorization for such orders or transactions is pursuant to a written agreement, except that discretionary orders may be placed with another member for execution.

Within the meaning of this subsection, an order which gives the floor broker discretion only as to time and price shall not be deemed to be a discretionary order. The restrictions set forth in this subsection shall not apply to discretionary orders for:

(1) members of the floor broker's immediate family, which is defined to mean a spouse, parent, parent of a spouse, child, or spouse of a child;

(2) a member of the Exchange; or

(3) a proprietary account of the floor broker, as that term is defined in §1.3(y) of the Regulations of the Commodity Futures Trading Commission.

(d) No floor broker shall disclose at any time that he is holding an order of another person or shall divulge any order revealed to him by reason of his relationship to such

other person except to execute an order or except pursuant to paragraph (c) of this Rule or at the request of an authorized representative of the Commodity Futures Trading Commission or the Exchange.

(e) No floor broker shall take, directly or indirectly, the other side of any customer order revealed to him by reason of his relationship to the customer except with the customer's prior written consent and in conformity with the Rules of the Exchange applicable to such transactions. Such consent need not be given for each transaction but may be given in general terms and must be filed with and retained by the floor broker or the clearing member by an instrument separate from any customer's agreement with the clearing member.

If the requisite prior consent is so filed, the transaction shall be effected in accordance with Rule 308, notwithstanding the provisions of subparagraph (e) thereof.

(f) No trading member shall make any purchase or sale which has been directly or indirectly prearranged.

(g) No floor broker shall allocate trades among accounts except in the sequence in which the orders for such accounts has been received. The sequence of time stamping of orders when received on the floor shall be prima facie evidence of the sequence in which such orders were received by a member. Trades executed for orders received at the same time shall be allocated on an equitable basis among the orders received; provided, however, that all orders received after the close on one trading day and prior to the opening on the next trading day shall be considered as received at the same time.

(h) No floor broker shall withhold or withdraw from the market any order or part of an order of another person for the convenience of another member.

(i)(1) Every execution of a transaction on the floor shall be confirmed promptly with the opposite trading member. Such confirmation shall identify price, quantity, and future or option.

(2) Every contract made on the Exchange shall be assumed by a member of the Exchange who is a clearing member of the clearing organization which clears contracts made on the Exchange. Every such contract when made by a trading member shall be made on behalf of a clearing member who shall be the buyer or seller of said contract on the terms set forth therein. The clearing member shall assume said contract in writing within one hour after receipt of a report from the trading member identifying the terms thereof.

* * *

**Settlement Price Computation**

**Rule 315** The settlement price for each contract, other than expiring contracts on the last trading day, shall be determined as follows:

(a) The settlement price shall be the average of all prices of the closing range of the contract involved. When an average is a fraction, the settlement price shall be the next full trading point above or below the fractional average depending on which is nearer to the last price recorded.

(b) If, for any contract, no transactions have been executed during the respective closing period, the settlement price for such contract shall be the average of the highest bid and the lowest offer during such closing

period; provided, however, that a bid or offer which is out of line shall not be considered.

(c) If there are no bids and offers for a contract during its closing period, the settlement price shall be determined by reference to the prevailing differences between such contract and the nearest active month of the respective contract market during the day in the case of a future, and the nearest active strike price of the same series in the case of an option.

(d) If a settlement price derived by employing the foregoing procedures is not consistent with trades in other months during the closing range or with market information known to the Futures and Options Contracts Committee, the Committee may establish a settlement price at a level consistent with such other trades or market information and shall prepare a written record setting forth the basis for such settlement.

(e) Notwithstanding the foregoing provisions of this Rule, on any day on which a cessation of trading of the NYSE Composite Index Futures contract pursuant to the Rule governing trading halts and daily price limits shall be in effect at the close of trading, the settlement price for each NYSE Composite Index Futures contract shall be at such expanded price limit as is applicable pursuant to said Rule.

* * *

**Margins**

**Rule 703** (a) The Exchange shall determine and notify members and member organizations of the minimum amount of initial margin and option margin which must be obtained by all members and member organizations from

customers, the amount of margin that must be maintained by customers, and the terms and conditions under which margin must be required and accepted from customers. The Exchange may establish different minimum initial option and maintenance margins for different classes of customers, and for different commodity interest transactions, accounts or positions.

(b) No member or member organization shall accept any order for new trades for any account to purchase or sell a futures contract or to grant an option contract unless the minimum initial margin and option margin established by the Exchange in the new trades is on deposit or is forthcoming within a reasonable time and unless the margin in that account's pre-existing open positions complies with applicable maintenance margin requirements established by the Exchange or is forthcoming within a reasonable time; provided, however, that if an account is under margined for an unreasonable time, a member or member organization may accept orders that only serve to reduce the risk of existing positions in the account.

(c) The member or member organization may call for additional margin at his or its discretion, but whenever a customer's margin is below the maintenance margin required by the Exchange, the member or member organization must call for such additional maintenance margin as will bring the account up to Exchange minimum initial margin and option margin requirements, and if within a reasonable time the customer fails to comply with such demand (the member or member organization may deem one hour to be a reasonable time), the member or member organization must close out the customer's position or sufficient contracts or options to restore the customer's account to required margin status.

(d) The terms and conditions under which margin must be required and accepted from customers shall be as follows:

(i) On each Exchange business day, each member or member organization shall compute, for each account with an open position in an Exchange futures contract or option contract, the open trade equity, total equity, initial margin required, initial margin on deposit, option margin required, option margin on deposit, and maintenance margin required for the account. The open trade equity in an account shall be calculated using the settlement prices published by the Exchange and any other contract market, as may be required.

(ii) Initial margin and option margin may be deposited by customers with a member or member organization only in one or more of the following forms:

(A) Cash.

(B) Obligations of the United States, provided, however, that such obligations shall not be accepted as initial margin or option margin for an amount not to exceed market value less applicable haircuts as described in Regulation 240.15c3-1 of the Securities and Exchange Commission.

(C) Securities listed for trading on the New York Stock Exchange, Inc. or the American Stock Exchange, Inc.; provided, however, that such securities shall not be accepted as initial margin or option margin for an amount not to exceed market value less applicable haircuts as described in Regulation 240.15c3-1 of the Securities and Exchange Commission.

(D) Irrevocable letter of credit.

(E) Credit in the customer's account arising from a loan made by the member or member organization for the collateral value of purchased options; provided, that the amount of credit extended by the member or member organization shall not exceed the collateral value of the purchased options determined in accordance with such procedures as may from time to time be established by the Exchange.

(e) No member or member organization shall accept any order for the purchase of an option contract unless the premium for that option contract is on deposit or forthcoming within a reasonable time.

(f) Premiums on purchased options may be deposited by customers with a member or member organization only in the form of cash.

---

## APPENDIX C

The Statement of the New York Clearing Corporation, as was available when the Futures Industry Association filed its brief as *amicus curiae* in support of petitioner before the court of appeals on October 10, 2006, provides in relevant part:

### Clearing Corporation Acceptance and Liability for Trades

The details surrounding all matched trades that have been accepted by a clearing member are submitted to the clearinghouse at the end of each day, where a confirmation process is conducted. By approximately, 10:00 p.m., the clearinghouse generates to each clearing member a report showing all of the trades that the clearinghouse has accepted for the account of the clearing member. In each mutually confirmed transaction, the clearinghouse is substituted as the buyer to the selling clearing member and the seller to the buying clearing member. Once substituted as the counterparty to a transaction, the clearinghouse may not reverse its acceptance of a trade. The Clearing Corporation has no liability to the customers of a clearing member or to any Exchange member that acted as broker for a clearing member. The Clearing Corporation has no liability to make or accept delivery under a futures contract.

## APPENDIX D

The By-Laws and Rules of the Board of Trade of the City of New York, as in effect when this case was filed on July 26, 2000, provide in relevant part:

**Margin Rule XXX Margin Requirements**

(a) Except as hereinafter provided, no carrying member shall carry an open position in a futures or option contract for an account, unless it collects the original margin required pursuant to the Rules within a reasonable time, except for good cause.

(b) Except as hereinafter provided, no carrying member shall accept any order for a futures or option contract if the execution of such order would result in an increase in the account's position, except for risk reducing trades, unless:

(i) the original margin and premium required for all existing futures and option contracts carried in the account has been deposited in accordance with the Rules (or the rules, if any, of the exchange where such futures contracts or options are traded) or the carrying member has issued a call for any margin or premium required and such call has not been outstanding more than a reasonable time, except for good cause; and

(ii) the net liquidating value of the account exceeds the maintenance level required pursuant to the Rules or the carrying member has a call for any margin required and such call has not been outstanding more than a reasonable time, except for good cause.

(c) No carrying member shall be required to obtain or call for original margin on new positions that are liquidated on the same Exchange business day.

(d)(i) No member of the Exchange with floor trading privileges shall execute a trade or place an order for the purchase or sale of any futures contract or the purchase or grant of any option if a debit or deficit balance exists in the account of such member or in any account in which such member directly or indirectly has an interest, except for the liquidation of existing positions, or with the prior approval of the President. A member of the Exchange with floor trading privileges shall immediately notify the Secretary of the Exchange if a debit or deficit or deficit balance of ten thousand dollars ($10,000) or more exists in any account or all accounts, combined, in which such member, directly or indirectly, has an interest.

(ii) A carrying member may not knowingly accept any trade or order which is violative of paragraph (d)(i) of this Rule, except for trades which the carrying member is obligated to accept as the clearing member guarantor of a member with floor trading privileges. A clearing member guarantor shall immediately advise the Exchange of any trades which it accepts pursuant to this paragraph.

(iii) A carrying member shall immediately notify the Secretary of the Exchange if a debit or deficit balance of ten thousand dollars ($10,000) or more exists in the account of a member with floor trading privileges or in any account in which such member, directly or indirectly, has an interest of which the carrying member has knowledge.

(e) No carrying member may release margin funds from an account unless such funds are in excess of the account's minimum original margin requirements.

(f) Each member firm which carries an account for a Futures Commission Merchant or a foreign broker on an omnibus basis, shall collect the original margin and maintenance margin required of such account on the basis of the gross position carried for such account.

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No. 06-1265

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SUPREME COURT, U.S.

# In the Supreme Court of the United States

KLEIN & CO. FUTURES, INC.,

*Petitioner,*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., ET AL.,

*Respondents.*

**On Writ Of Certiorari To**
**The United States Court Of Appeals**
**For The Second Circuit**

## BRIEF OF RESPONDENTS

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## QUESTION PRESENTED

Section 22(b)(1) of the Commodity Exchange Act prior to its amendment in December 2000 (7 U.S.C. § 25(b)(1) (1994)) created a private cause of action against futures contract markets and clearing organizations for "a person who engaged in any transaction on or subject to the rules of such contract market" seeking to recover "actual losses that resulted from such transaction and were caused" by the contract market or clearing organization's failure to enforce its rules or application of its rules in violation of the Act or the regulations or administrative orders thereunder.

The question presented is whether this cause of action was available only to persons who bought or sold futures contracts or options, or whether the cause of action also could be asserted by an entity that merely cleared another person's purchases or sales.

## RULE 29.6 STATEMENT

Board of Trade of the City of New York, Inc. (NYBOT), formerly a New York Not-for-Profit Corporation, states that following a January 12, 2007 merger, NYBOT's successor in interest is ICE Futures U.S. Inc., which is a wholly owned subsidiary of IntercontinentalExchange, Inc., a Delaware corporation publicly traded on the New York Stock Exchange. Respondent New York Clearing Corporation, now known as ICE Clear U.S. Inc., a clearing organization, and respondent New York Futures Exchange, Inc., a dormant contract market, state that they are wholly owned subsidiaries of ICE Futures U.S. Inc. Respondent New York Cotton Exchange no longer exists as it was merged into NYBOT.

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## STATEMENT

After a futures or options trade takes place on the floor of a futures exchange designated as a "contract market" under the governing statute, that trade is "cleared" by the clearing organization associated with the contract market. Clearing establishes a series of relationships, specified in the rules of the clearing organization, among the buyer, the buyer's "clearing member," the seller, the seller's "clearing member," and the clearing organization that are designed to guarantee the performance obligations of the buyer and seller.

As a clearing member, petitioner was obligated by clearing organization rules to make certain payments to the clearing organization based on the change in value of the futures contracts and options held by petitioner's customers. Petitioner went out of business when it was unable to make these payments as a result of the failure of one of its customers to meet a margin call made by petitioner. Petitioner commenced this action under 7 U.S.C. § 25(b)(1) against, among others, the contract market and the clearing organization where that customer's trades were executed and cleared respectively, alleging that they failed to enforce certain contract market rules in failing to prevent the principal of petitioner's customer from using his position on a contract market committee to understate improperly the customer's margin obligation.

Section 25(b)(1)[1] establishes a private right of action for a person who "engaged in any transaction on or subject to the

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[1] We agree with the Solicitor General (Br. 3 n.1) that this case is governed by the version of the Commodity Exchange Act (CEA) in effect when this case was filed in July 2000. Like the government and petitioner we use "Section xx" to refer to the section of title 7 of the United States Code rather than the section of the CEA. Unless otherwise indicated, references to the C.F.R. and rules of the NYBOT, NYFE, and NYCC likewise refer to those rules in effect when this case was filed.

rules" of a contract market to the extent that he has suffered "actual losses that resulted from such transaction" and that those actual losses were caused by the failure of a contract market or its clearing organization to enforce its rules. Every court to consider the issue has concluded that the phrase "any transaction on or subject to the rules" of a contract market limits the cause of action to persons who buy and sell futures contracts or options. Congress used "on or subject to the rules of" a contract market repeatedly in the statute, each time to refer specifically to trading of futures contracts and options. Moreover, Section 25(b)(1) was enacted shortly after this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353 (1982), which focused exclusively on claims asserted by traders in upholding the implied cause of action that Section 25 replaced.

Congress also strictly limited the damages recoverable under Section 25(b)(1) to the plaintiff's "actual losses that resulted from" its transaction, which must be caused by the defendant's alleged failure to enforce its rules or alleged violation of the law in enforcing those rules. Petitioner's claim fails that test as well: its alleged damages resulting from the collapse of its business did not result from a transaction, they resulted from the lack of creditworthiness of petitioner's customer. The court of appeals correctly concluded that petitioner's "loss was a credit loss, not a trading loss." Pet. App. 12a.

### A. Statutory And Regulatory Background

1. A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future for a specified price. JOHN C. HULL, OPTIONS, FUTURES, AND OTHER DERIVATIVES 6 (6th ed. 2006). The practice of entering into futures contracts originated in connection with agricultural commodities. "When an entire crop was harvested and marketed within a short time-span, dramatic price fluctuations sometimes created severe hardship for farmers or for processors"; these risks were alleviated by "the practice of

'forward contracting'—the use of executory contracts fixing the terms of sale in advance of the time of delivery." *Curran*, 456 U.S. at 357.

As this Court explained in *Curran*, "[b]ecause the weather and other imponderables affected supply and demand, normally the market price would fluctuate before the contract was performed. A declining market meant that the executory agreement was more valuable to the seller than the commodity covered by the contract" because it permitted the seller to obtain more than the market price for his goods. *Curran*, 456 U.S. at 357. "[C]onversely, in a rising market the executory contract had a special value for the buyer, who not only was assured of delivery of the commodity but also could derive a profit from the price increase." *Ibid.*

The opportunity to profit from these market price fluctuations "motivated speculators to engage in the practice of buying and selling 'futures contracts'" and "led to the development of recognized exchanges or boards of trade." *Id.* at 357-358. The exchanges brought standardization to the practice of trading futures contracts, making contracts fungible by developing "standard terms describing the quantity and quality of the commodity, the time and place of delivery, and the method of payment; the only variable was price." *Id.* at 358.

Futures contracts for agricultural commodities and raw materials, such as metals, were long traded on futures markets, but in the 1970s trading began in futures contracts on Treasury bills and municipal bonds; in 1982, trading began on stock index futures. ROBERT W. KOLB, FUTURES, OPTIONS, AND SWAPS 25 (2d ed. 1997). Trading in stock index futures provides an opportunity to speculate on larger-scale future movements in the stock market, and also plays a crucial role in hedging portfolio risk. *Id.* at 221. Futures exchanges today also provide a market for trading options on futures contracts (similar to the trading in options on a com-

pany's stock).[2] In all respects relevant here, the rules governing trading of options on futures are essentially the same as those governing trading of futures contracts.

2. Futures trading has been subject to federal regulation since the predecessor to the Commodity Exchange Act (CEA), 7 U.S.C. § 1 *et seq.*, was enacted in 1922. In the 1974 CEA amendments, Congress created the Commodity Futures Trading Commission (CFTC) to exercise regulatory authority in this area.

The linchpin of the CEA's regulatory scheme is Section 6(a)(1), which bans futures trading (with exceptions not relevant here) unless a "transaction is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market' for such commodity." A "contract market" is a board of trade designated by the CFTC pursuant to 7 U.S.C. § 7. The subsidiary companies of the Board of Trade of the City of New York, including the New York Futures Exchange and New York Cotton Exchange, were contract markets. Other contract markets include the Chicago Board of Trade, and the Chicago Mercantile Exchange.

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[2] "An option on a futures contract or a futures option is an option that takes a futures contract as its underlying good." KOLB, *supra*, at 4. With a futures option "the call owner receives a long position in the underlying futures at the settlement price prevailing at the time of exercise" and, upon exercise, "a payment that equals the settlement price minus the exercise price of the futures option." *Ibid.* A call seller "receives a short position in the underlying futures at the settlement price prevailing at the time of exercise" and, upon exercise, "pays * * * the futures settlement price minus the exercise price." *Ibid.* The exercise of a futures put option works as a mirror image, with the owner of the futures put option receiving a short position and a payment equaling the exercise price minus the futures settlement price, and the put seller receiving a long position and paying the exercise price minus the settlement price. *Id.* at 5.

Futures traders "broadly speaking * * * fall into two general classifications, i.e. 'trade' hedging customers, and speculators. All orders which reach the trading floor originate with one or the other group of traders." *Curran*, 456 U.S. at 359 n.11 (internal quotation marks omitted). "Hedgers" are "[t]hose who actually are interested in selling or buying the commodity"; "'speculators' or 'investors'" are "[t]hose who seek financial gain by taking positions in the futures market generally." *Id.* at 359. The CFTC rules use the terms "customer" and "commodity customer" to refer to futures traders. 17 C.F.R. § 1.3(k).

A futures trader that is not a member of a futures contract market may buy or sell futures contracts through a "futures commission merchant" (FCM). The CEA defines an FCM as a person "engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market" who accepts funds or property "to margin, guarantee, or secure" trades or contracts. 7 U.S.C. § 1a(12).

The FCM generally will effectuate the customer's transaction by placing the customer's order through a "floor broker"—the person who in a "place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market." 7 U.S.C. § 1a(8).[3]

[3] The Futures Industry Association asserts (Br. 2) that "[i]ndividual customers * * * must carry out their transactions through brokerage firms called futures commission merchants," and that "[s]uch merchants arrange for the execution of customer orders either through floor brokers in a trading pit or on a computerized trading screen, as specified in the rules of the relevant exchange." Although Chicago-based futures exchanges may require customer orders to be placed through FCMs, on New York exchanges such as NYFE, orders may be placed by customers directly with floor brokers or may be initiated by floor brokers in accordance with discre-

A significant proportion of futures and options trading consists of proprietary trading by contract market members for their own accounts, acting in the capacity of a "floor trader," which the statute defines as a person who "in or surrounding any * * * place provided by a contract market for the meeting of persons similarly engaged, purchases, or sells solely for such person's own account, any commodity for future delivery on or subject to the rules of any contract market." 7 U.S.C. § 1a(9).

After a floor broker (on behalf of a customer) or a floor trader (on his own behalf) has executed the purchase or sale of a futures or options contract, that purchase or sale must be "cleared" by the "clearing organization" for the contract market on which the transaction occurred. NYFE Rule 306(i)(2) (Pet. Br. App. 14a). The mechanics of this clearing process are unique to futures and options markets. Clearing creates a series of new relationships, specified in the rules of clearing organizations, that provide guarantees for the performance obligations of the buyer and seller that facilitate trading—and therefore enhance the depth of the market—by substantially eliminating traders' concerns that a potential counterparty might not perform due to lack of creditworthiness or otherwise.

The clearing process is complex and varies among contracts markets.[4] We discuss the process specified for the customer trades at issue here—trades on the New York Futures Exchange (NYFE).

The NYFE rules provided that "[e]very contract made on the Exchange shall be assumed by a member of the Exchange who is a clearing member of the clearing organization which clears contracts made on the Exchange." Rule 306(i)(2) (Pet.

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tion granted by their customers. See NYFE Rule 306(c) (Pet. Br. App. 12a).

[4] That is why petitioner's repeated references to the practices of the Chicago markets (*e.g.*, Br. 4-9) are inapposite here.

Br. App. 14a). The New York Clearing Corporation (NYCC) is the clearing organization that cleared contracts made on the NYFE.

A "clearing member" of the NYCC that has "assumed" a contract has "the privilege to clear with [NYCC] Contracts effected on or subject to the rules of an Exchange." NYCC Bylaw 1.1 (J.A. 94). The NYCC rules state that upon its acceptance of the contract for clearing, the NYCC:

> shall assume, in the place of each Clearing Member that is a party to such Contract, all liabilities and obligations imposed thereby to the Clearing Member that is the other party thereto, to the extent provided in [the NYCC rules], and shall succeed to and become vested with all rights and benefits accruing therefrom. ***Such assumption by the Corporation shall terminate all liabilities and obligations of the Clearing Member whose Contract is so accepted to the other Clearing Member which was a party to such Contract.***

NYCC Rule 401(a) (Resp. App. 6a) (emphasis added). The clearing organization's liability does not extend "to any customer of a clearing member." *Id.* Rule 401(b)(i).

The clearing process thus creates two new agreements—one between the NYCC and the buyer's clearing member and the other between the NYCC and the seller's clearing member—and eliminates any liability of a clearing member on the original contract between the buyer and seller. In return, each clearing member agrees to satisfy to NYCC the obligations of the clearing member's customer under the original contract. The clearing member thus becomes a party to an agreement different than the contract between the buyer and seller—an agreement between itself and the clearing organization in which the clearing member agrees to pay to the clearing organization in accordance with the clearing organization's rules the net amount due with respect to the contracts

carried in the clearing member's customer account with the clearing organization. The buyer and seller remain the beneficial owners of their contract executed on the contract market floor, and remain entitled to that contract's benefits and subject to its obligations.

The obligation between a clearing member and the NYCC flows from the NYCC rule requiring clearing members to "deposit with or pay to [the NYCC] original margin, variation margin and option premiums for each cleared Contract" in amounts specified by the NYCC rules. NYCC Rule 502(a) (J.A. 171). The amount of original margin required to be on deposit with the NYCC from any clearing member is determined each day in accordance with a formula applied to the position in futures contracts and options carried by the clearing member. That amount may fluctuate from day to day depending on changes in the size and composition of that position (as a result of trading activities, contract expirations, etc.), together with profits or losses on short options positions occurring during the day.

The amount of variation margin to be paid or received by any clearing member is determined each day by any net losses or net profits on its futures contract positions during the day. NYCC Rule 502(c) (J.A. 171). The amount of option premiums to be paid or received by any clearing member is determined each day by the net amount of premiums on options purchased and sold during the day. Profits or losses on options and on futures contracts are determined by reference to "settlement prices" calculated as prescribed in the rules of either the contract market or the clearing organization. See NYFE Rule 315 (Pet. Br. App. 14a-15a). The CEA makes clear that a clearing organization may not treat funds deposited with it "as belonging to * * * any person other than the customers" of the depositing clearing member. 7 U.S.C. § 6d.

When a customer opens an account with a clearing member, the customer will be required to deposit funds into

that account to assure his performance, which must at least equal the "original margin" required by the contract market.[5] The clearing member is required to treat all funds "received * * * to margin, guarantee, or secure the trades or contracts of any customer * * * or accruing to such customer as the result of such trades or contracts, as belonging to such customer." 7 U.S.C. § 6d(2); see 17 C.F.R. § 1.21 (specifically addressing funds received "from any clearing organization" with respect to customer trades). This ensures that the customer will obtain the economic benefit of its trades. The customer's agreement with the clearing member in turn makes the customer responsible to cover the full amount of any losses.

Under NYFE rules, the minimum required amount of such margin is initially determined in accordance with a formula applied to the position in futures contracts and options carried by the customer, and is adjusted daily to reflect changes in the size and composition of that position and to reflect profits or losses on the futures contracts and options in that position. NYFE Rule 703 (Pet. Br. App. 15a-18a). In the event that the net equity in a customer's account falls below a maintenance level prescribed in the exchange rules or in the customer's agreement with the clearing member (U.S. Br. 8), whichever is greater, the clearing member issues a margin call to the customer requiring the customer to deposit additional margin in an amount sufficient to restore the net equity to the minimum. The profits and losses on the futures contracts and options are determined by reference to the same settlement prices as are used in determining the original

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[5] The customer-clearing member relationship is regulated by the rules of the contract market. Only FCMs may act as clearing members for customers, because the statute permits only FCMs to hold customer funds to margin, guarantee or secure customer trades and contracts. See page 5, *supra*. A non-FCM clearing member may only clear that entity's proprietary trades.

and variation margin obligations of the clearing member to the clearing organization.

The statute and rules thus make clear that (a) floor brokers (on behalf of their customers) purchase or sell futures or options contracts on or subject to the rules of a contract market (7 U.S.C. § 1a(8)); (b) it is those contracts that a clearing member has the "privilege" to clear (NYCC Bylaw 1.1 (J.A. 94)); and (c) the clearing member's "assum[ption]" of the contract between the buyer and seller is quite transitory—it ends as soon as the contract is cleared, because at that moment any obligations by the clearing member to the opposite clearing member or opposite customer on that contract cease (NYCC Rule 401(a) (Resp. App. 6a)) and are replaced by the clearing member's obligations to the NYCC and to its customer.[6]

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[6] Petitioner states (Br. 7) that there is no completed contract until after a trade is cleared. But the NYCC Bylaws define "clearing member" as a person that has "the privilege to clear with [NYCC] ***Contracts effected on or subject to the rules of an Exchange***." NYCC Bylaw 1.1 (J.A. 94) (emphasis added); see also NYCC Rule 401(a) (Resp. App. 6a) ("[t]hc [NYCC] * * * shall assume, in the place of each Clearing Member that is a party to ***such Contract***") (emphasis added). Petitioner's position is thus squarely inconsistent with the NYCC and NYFE rules. Indeed, NYFE Rule 306(i)(2), on which petitioner relies, refers to "[e]very ***contract made on the Exchange***" (emphasis added), thus recognizing that a contract exists before clearance takes place. Pet. Br. App. 14a.

Petitioner also asserts (Br. 24-25, 35-36) that the clearing members are the original parties to the contract made on the floor of the Exchange, pointing to the second sentence of Rule 306(i)(2). As we discuss in detail below (see pages 40-42, *infra*), petitioner's construction of the rule ignores the plain language of the other two sentences and is plainly wrong.

These conclusions are confirmed by the real-world operations of the NYFE and NYCC that are not addressed by petitioner. The Trade Input Processing System (TIPS) that existed in 2000 "auto-

3. In its 1982 decision in *Curran*, this Court held that "the private cause of action under the CEA that was previously available to investors [under judicial decisions implying a cause of action under the statute] survived the 1974 amendments" to the statute. 456 U.S. at 388. Eight months after this Court's decision, Congress amended the CEA to—among other things—replace this implied remedy with an express cause of action.

Section 25 created two separate, but related, causes of action. The first, set forth in subsection (a), provides that a private action may be asserted against "any person (***other than*** a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association)" whose violation of the CEA causes "actual damages resulting from one or more" of four specified transactions (emphasis added). 7 U.S.C. § 25(a)(1). For example, a person "who received trading advice * * * for a fee" may sue a person who violated the Act for damages that resulted from the receipt of that advice and were caused by the violation. *Id.* § 25(a)(1)(A). And a futures trader may sue floor brokers and FCMs for actual damages resulting from trading caused by those defendants' violations of the Act. *Id.* § 25(a)(1)(B).

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mate[d] the entire process of trade matching, validation, verification and correction" upon the entry by a broker's clerk of "the trade data that appear on his broker's trading card." CFTC Div. of Trading and Markets, *Rule Enforcement Review of the New York Cotton Exchange* 5 n.12 (Sept. 26, 2001). After the close of trading each day, TIPS provided to NYCC a database showing all transactions where the data supplied by one trading member matched the data supplied by another trading member. NYCC then ran the information so provided through its system to generate reports to the clearing members showing the matched transactions for which they had assumed responsibility for clearing, whereupon those transactions were deemed as having cleared, pursuant to NYCC Rule 402(b). Resp. App. 8a.

The second, set forth in subsection (b), addresses claims against the entities excluded from the previous subsection; paragraph (b)(1) addresses claims against contract markets, clearing organizations of contract markets, and licensed boards of trades. It imposes liability for "actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by" the defendant's enforcement of its rules in violation of the Act or CFTC regulation or order, or by the failure to enforce a rule that the Act or the CFTC required it to enforce. 7 U.S.C. § 25(b(1).

The question presented here requires the Court to determine whether the cause of action created by Section 25(b)(1) may be invoked only by futures traders—the customers and proprietary traders that purchase and sell futures contracts and options and that were the sole focus of the Court's decision in *Curran*—or extends broadly to include clearing members (and, under petitioner's theory, a variety of other actors) that merely facilitate trades entered into by others.

**B. The Events Underlying This Case**

1. This case arises out of trading on the NYFE by First West Trading, Inc., of Pacific Stock Exchange Technology Index futures contracts and options (P-Tech futures and options) during 2000. Norman Eisler, the principal of First West, directed the trading. Because Eisler was both a floor broker and a member of the NYFE, he executed those trades for First West on the floor of the exchange using the traditional "open outcry" system. Pet. App. 3a-4a; J.A. 17-18 (¶¶ 56-57 & 59); see also pages 5-6, *supra*.

First West had a customer account at petitioner Klein & Co. Futures, Inc. (Klein), which was a clearing member of the clearing organization for NYFE trades, the New York Clearing Corporation (NYCC). J.A. 17 (¶ 55). In its capac-

ity as a clearing member, Klein cleared First West's trades, which had been executed by Eisler. J.A. 17-18 (¶¶ 55, 56, 59, 61).[7]

Pursuant to NYCC rules (see page 8, *supra*), the variation margin obligation of Klein, as the clearing member, was calculated on the basis of changes in "settlement price." See page 8, *supra*. For futures contracts and options on a stock index, such as those involved here, the NYCC rule regarding calculation of settlement prices references the procedure for calculating the settlement price established by the exchange (here, NYFE) on which the contract is traded. NYCC Rule 502(c) (J.A. 170). The relevant NYFE rule specified an arithmetic procedure for calculating the settlement price but in some circumstances allowed the exercise of discretion (if a written record was prepared "setting forth the basis for such settlement"). NYFE Rule 315(d) (Pet. Br. App. 15a).

Klein's NYFE membership obliged Klein to require that First West post a minimum amount of margin with Klein with respect to the futures contracts and options cleared by Klein. That amount too was dependent on the settlement price. NYFE Rule 703; J.A. 21 (¶ 81) (discussing First West's margin obligation).

2. Eisler was the chairman of the NYFE and, in addition, a member of the Exchange's settlement committee responsible for establishing the settlement price of P-Tech futures and options. Pet. App. 3a; J.A. 11 (¶ 10); NYFE Section 2.19 (Resp. App. 11a).

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[7] Klein also was registered with the CFTC as an FCM, which entitled it to solicit and accept orders for futures contracts. See page 5, *supra*. Klein did not act in that capacity with respect to First West's trades, however, because those trades were originated and executed by Eisler, not by Klein—with Eisler designating Klein as the clearing member with respect to his trades. J.A. 17 (¶ 57) (Klein acknowledging in complaint that it did not "exercise control over the trading in [First West's] account").

Petitioner alleges that Eisler abused his position on the settlement committee to misprice the P-Tech settlement prices each day, which had the effect of artificially inflating the value of First West's futures contracts and options and artificially depressing the amount of margin that First West owed to Klein and that Klein, in turn, owed to NYCC. J.A. 18 (¶¶ 60-62); Pet. App. 4a.

On May 11, 2000, the margin call for First West's account was calculated to be approximately $700,000 on the basis of the (erroneous) settlement price established by the settlement committee. Pet. App. 4a; J.A. 21 (¶ 80). Eisler told Klein "that he did not know if he had enough funds to cover the margin," and Klein instructed him to liquidate First West's position; the following day Eisler said "that he did not have the funds to cover the margin." J.A. 21-22 (¶¶ 81-84). Eisler's Exchange membership was suspended and he was removed from the settlement committee. "Once this occurred, the remaining Committee members recalculated the settlement prices and First West's margin deficit ballooned to $4.5 million." Pet. App. 5a; J.A. 24-25 (¶¶ 96, 99-101).

In accordance with NYCC rules, Klein was required to take a charge against its net capital to cover First West's failure to meet Klein's margin call to it. That reduced Klein's capital to less than the minimum amount required by the NYCC's rules. Thereafter, Klein's memberships in the NYFE and NYCC were suspended. J.A. 25-26 (¶¶ 102-107). Klein ceased business operations on May 16. J.A. 28 (¶ 116).[8]

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[8] The CFTC filed an administrative enforcement action against Eisler and First West, which was settled by entry of a consent order requiring payment of a civil penalty of up to $4.9 million. *In re Eisler & First West Trading, Inc.*, No. 01-14 (Jan. 20, 2004), at http://www.cftc.gov/files/enf/04orders/enfeisler-order.pdf. The NYFE consented to the entry of an order imposing a $75,000 civil penalty. The findings—which NYFE neither admitted nor de-

When Klein failed to pay the NYCC margin call, NYCC applied the funds held in Klein's customer margin account to meet the NYCC margin call. J.A. 26-28 (¶¶ 111-113). The New York Board of Trade (NYCC's parent), paid those customers an amount equal to that owed to them by Klein in return for assignment of those customers' claims against Klein. Pet. App. 28a-29a & n.13.

**C. Proceedings Below**

Klein in July 2000 commenced this action against Eisler, First West, NYFE and NYCC, the New York Cotton Exchange (at the time the parent of NYFE), and the Board of Trade of the City of New York (NYBOT, at the time the parent of the Cotton Exchange, NYFE, and NYCC) (collectively "the Exchanges and the Clearing Organization") and certain officers and directors of the Exchanges and the Clearing Organization. Klein alleged that some exchange officers had been aware of complaints regarding the P-Tech settlement prices and had failed to make a prompt inquiry into the matter or provide notice of the complaints. J.A. 18-19, 20 (¶¶ 64, 72-73). Klein also alleged that it had requested that the NYFE Board take emergency action to halt trading of P-Tech futures and options, but no such action was taken. J.A. 23-24 (¶¶ 90, 95). Finally, it claimed that exchange officers exempted Klein from depositing required funds in the NYCC guaranty fund in order to conceal Eisler's wrongful activities. J.A. 20-21 (¶¶ 75-79).

The complaint asserted claims under Section 25 of the CEA and state law. J.A. 29-53. Claiming that the alleged

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nied —stated that the Exchange's Settlement Committee had failed to comply with the rule for establishing settlement prices for P-Tech futures contracts and options by failing to prepare a written record setting forth the basis for such settlements. *In re New York Futures Exch., Inc.*, No. 01-13 (CFTC July 11, 2001), at http://www.cftc.gov/files/enf/01orders /enfnyfe.pdf.

violations caused it to go out of business, Klein sought compensatory damages of $25 million. J.A. 54-57.[9]

*1. **The District Court's Decision.***

The district court dismissed Klein's Section 25 claim against the exchanges and clearing organization and their officers and directors. Pet. App. 16a-34a.

Referring to Section 25(b)'s limitation of the cause of action to "a person who engaged in any transaction on or subject to the rules" of a contract market, the district court determined that "[c]ourts have interpreted this provision to mean that only ***purchasers or sellers*** on the contract market have a right of action pursuant to [the provision]. Non-traders have no such private right of action under the CEA." Pet. App. 23a-24a (emphasis in original). Observing that Klein "does not allege that it was either a purchaser or a seller of P-Tech Futures and Options" and that Klein "does not claim that it traded for its own account," the district court concluded that Klein's claim did not meet the statutory prerequisite for asserting the cause of action. *Id.* at 24a.

The district court further determined that Klein "suffered damages because of its customer First West's inability to cover its margin call after the settlement price was recalculated. Quite simply, it did not suffer its damages in the course

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[9] NYBOT and NYCC in 2001 commenced an action against Klein, asserting the assigned claims of Klein's former customers. Standing in the shoes of those former customers, NYBOT and NYCC alleged that Klein violated 7 U.S.C. § 6d(2) when it utilized its customers' funds to satisfy its own debts to the NYCC and did not reimburse its customers. Pet. App. 27a-28a. As assignees, NYBOT and NYCC sought to recover the $4.5 million that Klein failed to pay to its customers. See page 15, *supra*.

The district court concluded that the initial complaint in that action failed to state a claim, but granted NYBOT and NYCC leave to amend. Pet. App. 33a. An amended complaint was filed on April 14, 2005.

of its trading activities on a contract market. Klein, therefore, does not have standing to allege a private cause of action" under Section 25(b). Pet. App. 25a.

*2. The Court of Appeals' Decision.*

The court of appeals unanimously affirmed. Pet. App. 1a-15a. The court observed that "Section [25(b)'s] remedies are expressly available only to a private litigant who 'engaged in any transaction on or subject to the rules' of contract markets or other registered entities" and Klein "was not an owner of P-Tech contracts traded by First West." *Id.* at 11a.

Klein argued that clearing members were "'forced' purchasers or sellers" when they "suffered damages arising from obligations to guarantee their customers' trades" as a result of activities regulated by federal law and the rules of the NYFE and NYCC. Pet. App. 11a. But, the court stated, Klein was neither a trader in nor an owner of the P-Tech contracts: "[i]ndeed, * * * Klein stated in its complaint that it had no financial interest in the First West trading activity and had nothing to do with its trading decisions. Consequently, regardless of whether the First West trading position rose or declined in value, Klein had no interest in any of the resulting profits or investments losses." *Id.* at 12a.

The court explained that "'Klein suffered damages because of its customer First West's inability to cover its margin call. . . .' Thus, Klein's loss was a credit loss, not a trading loss." Pet. App. 12a. "Enforcing the statute that Congress wrote, we conclude Klein lacks standing because it was not 'engaged in any transaction on or subject to the rules' of a contract market and did not suffer any 'actual losses that resulted from such transaction' as required by" Section 25(b). *Id.* at 13a.[10]

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[10] The district court declined to exercise supplemental jurisdiction over Klein's state law claims and therefore dismissed those claims

## SUMMARY OF ARGUMENT

Congress's decision to limit the Section 25(b)(1) cause of action to buyers and sellers of futures contracts and options is clear from the language Congress employed, the legal background against which Congress acted, the legislative history, and the absurd results that would flow from the broad interpretation advanced by petitioner and its amici. The lower courts' unanimous view that the remedy may be invoked only by traders should be upheld by this Court.

*First*, in restricting the cause of action to persons who "engage in any transactions on or subject to the rules of" a contract market, Congress invoked terms—"transactions" and "on or subject to the rules of" a contract market—that it used repeatedly in the CEA when referring specifically to investors' trades of futures contracts and options on the floor of a contract market and, in addition, the trades that the statute allows to occur off the exchange floor. Those terms have the very same meaning in Section 25(b)(1).

Petitioner's argument that the cause of action is available to anyone who participates in any type of activity that is in any way regulated by contract market rules rests on an interpretation of "any transactions" that ignores the settled meaning of the words Congress chose to limit the scope of that phrase. The government takes a similar approach with respect to "engage in," asserting that a person who engages in activity that is in any way ***related to*** a previously-executed transaction is a person who engages in the transaction itself. That interpretation makes no sense: one cannot engage in a transaction that has already taken place; rather, such a person engages in activity that helps implement the transaction.

*Second*, Congress enacted Section 25(b)(1) just six months after this Court's decision in *Curran* holding "that the private cause of action under the CEA that was previ-

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as well (Pet. App. 26a-27a); the court of appeals affirmed that determination (*id.* at 13a-15a).

ously available to ***investors*** survived the 1974 amendments." 456 U.S. at 388 (emphasis added). Acting against that backdrop, Congress would have made clear any intent to expand the cause of action beyond the bounds indicated in *Curran*. Not only is there no such indication in Section 25(b)(1), but Congress instead employed the very terms that it used repeatedly in the CEA to reference futures trading.

*Third*, the legislative history of Section 25(b)(1) provides additional support for the conclusion that the cause of action is limited to traders of futures contracts and options. The committee reports repeatedly refer to protecting "investors" and characterize *Curran* as permitting claims by "investors," "speculators," and "customers."

*Fourth*, accepting petitioner's interpretation of the provision would lead to absurd results. Investors' ability to invoke the provision might be eliminated; at a minimum, investors' recoverable damages would be reduced. And contract markets and clearing organizations would be subjected to multiple—and duplicative—claims by any person whose actions are in any way regulated by contract market rules. The Court in other contexts has rejected interpretations of private causes of action that would lead to such duplication.

Affirming the settled interpretation of Section 25(b)(1) will not produce a gap in enforcement of the rules governing futures and options trading. To the contrary, the CFTC possesses extremely broad enforcement authority, including the ability to levy fines, issue cease and desist orders, and bar individuals and entities from any involvement in the commodities markets. Regulatory oversight and enforcement provide strong punishment and deterrence in this area.

Even if the Court rejects our position and decides to expand the scope of the cause of action to non-traders, it nonetheless should affirm the judgment below on the ground that petitioner's complaint does not allege "actual losses that resulted from" its activities "on or subject to the rules of" a

contract market and that "were caused by" the contract market's failure to enforce its rules. If the Court overturns the settled understanding of Section 25(b)(1), lower courts will need guidance on the causation requirement so that they will be able to weed out the unduly remote claims that can be expected under a newly-expanded private cause of action. Here, the court of appeals properly concluded that "'Klein suffered damages because of its customer First West's inability to cover its margin call. . . .' Thus, Klein's loss was a credit loss, not a trading loss." Pet. App. 12a (internal citation omitted). Such damages are not recoverable under Section 25(b)(1).

## ARGUMENT

### I. SECTION 25(b)(1) CREATES A CAUSE OF ACTION ONLY FOR PERSONS ENGAGED IN TRADING FUTURES OR OPTIONS CONTRACTS.

Section 25(b)(1) creates a strictly limited private cause of action against contract markets. Claims may be asserted only by "a person who engaged in any transaction on or subject to the rules of" a contract market. 7 U.S.C. § 25(b)(1). The language Congress chose makes clear its intent to provide a cause of action only for persons who trade futures. Clearing a trade simply does not fit within the plain language of the provision. The legal context at the time the provision was enacted and the legislative history confirm that conclusion. The court of appeals correctly concluded that the Section 25(b) cause of action may be invoked only by those who trade futures contracts and options; because Klein "was not a trader of P-Tech contracts" and "did not own the P-Tech contracts at issue" it could not assert the cause of action. Pet. App. 12a.[11]

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[11] Petitioner erroneously asserts (Br. 3) that the court of appeals' decision rests on a "misread[ing] of the plain text" of Section 25(b) because the court discussed the four categories of transactions for

### A. The Plain Language Of Section 25(b)(1) Limits The Class Of Plaintiffs To Buyers And Sellers Of Futures Contracts.

Relying principally on the asserted breadth of the words "any transaction" when separated from the rest of the provision, and—indeed—from the rest of the statute, petitioner and the government assert that anyone who engages in any activity governed in any way by the rules of a contract market may invoke the cause of action created by Section 25(b)(1). That construction, which is inconsistent with every lower court decision interpreting the provision, is wrong. Congress in the CEA employed the phrase "person who engaged in any transaction on or subject to the rules of such contract market" to convey a particular, and limited, meaning—a person who engaged in the buying or selling of futures contracts.[12]

#### *1. Three aspects of the language Congress chose restrict the scope of the Section 25(b)(1) action.*

Congress's limitation of the private cause of action to buyers and sellers of futures contracts is manifest in (1) its use of the term "transactions on or subject to the rules of" a contract market; (2) its decision to exclude transactions "on or subject to the rules of" a clearing organization; and (3) the

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which Section 25(a) provides a cause of action. But subsection (a) was relevant to that court's decision because petitioner had appealed the dismissal of its claims against Eisler and the Exchange and Clearing Organization officers and directors; those claims are limited to the four transactions specified by subsection (a). See 7 U.S.C. § 25(b)(3). And—as we have discussed—the court of appeals specifically explained the reasons why petitioner was not a "person who engaged in any transaction on or subject to the rules of such contract market" entitled to invoke Section 25(b)(1).

[12] The CFTC's views on the scope of the private cause of action are not entitled to deference. *Adams Fruit Co.* v. *Barrett*, 494 U.S. 638, 649 (1990).

statute's restriction of recoverable damages to "actual losses that resulted from such transaction."

***a. "Transactions on or subject to the rules of" a contract market.*** Congress in the CEA normally used the word "transaction" when referring to a trader's purchase or sale of futures contracts or options. Thus, the provision granting exclusive jurisdiction to the CFTC refers to

> agreements (including any transaction which is of the character of or is commonly known to the trade as an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market.

7 U.S.C. § 2(i); see also *id.* §§ 6c (identifying "prohibited transactions," all of which are purchases or sales), 13(c) (barring CFTC Commissioners and employees from engaging in specified "transactions," all of which are purchases or sales).

Similarly, in its legislative findings, Congress repeatedly used the word "transaction" to refer to trades in futures or options:

> Transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest. Such futures transactions are carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the products and byproducts thereof in interstate commerce. The prices involved in such transactions are generally quoted and disseminated throughout the United States * * *.

7 U.S.C. § 5 (emphasis added).

The CFTC's rules follow the same approach. "Transaction" is repeatedly used by the CFTC as a synonym for "trade." See, *e.g.*, 17 C.F.R. § 1.35(b)(2) (requiring each FCM to keep a record of "transactions," and then listing a number of "transactions" that are all trades); *id.* § 1.35(e) (requiring contract markets to keep records showing "for each futures or option trade: the transaction date, * * * whether the transaction involved a put or a call," and showing "any transaction which is made non-competitively in accordance with written rules of the contract market"); *id.* § 155.2(i) (requiring contract markets to have rules which among other things require "that every execution of a transaction on the floor * * * be confirmed promptly").[13]

Moreover, the word "transaction" does not stand alone in Section 25(b)(1). Rather, the provision provides a cause of action only with respect to transactions "on or subject to the rules of" a contract market.

Throughout the CEA, Congress employed the phrase "on or subject to the rules of [a] contract market" to refer specifically to investors' trades of futures contracts and options executed on the trading floor of a contract market together with the trades that the statute permits "ex-pit" (off the exchange floor)—such as "exchanges for physicals," transfer trades, and office trades—which may be executed "off exchange" only if they are subject to the rules of a contract market.[14]

[13] Like the statute and the Commission's rules, the NYFE rules repeatedly equate a "transaction" with a "trade." See, *e.g.*, NYFE Rules 14, 302, 303, 313, 601. Resp. App. 11a-21a. For example, NYFE Rule 303(e) refers to "[t]ransactions made in any contract at a price above that at which such contract is offered or below that which is bid for such contract." Resp. App. 12a.

[14] 7 U.S.C. § 6c permits "the exchange of futures in connection with cash commodity transactions or of futures for cash commodities, or of transfer trades, or office trades if made in accordance with board of trade rules applying to such transactions and such rules shall have been approved by the Commission." Exchanges of futures for cash commodities, otherwise known as exchange-

Congress's use of that very same phrase to modify "transactions" in Section 25(b) makes clear that it intended to provide a cause of action only to the buyers and sellers in these particular transactions. See *Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 575 (1995) (in statutory construction, "a word is known by the company it keeps").

In each of the many instances when Congress used the phrase "on or subject to the rules" it did so to modify a word or phrase that is synonymous with a trade. For example, Section 6i, which governs reports of transactions in excess of trading limits, reaches "any contract for the purchase or sale of any commodity for future delivery on or subject to the rules of any exchange." 7 U.S.C. § 6i; see also *id.* §§ 1a(5)(A)(i)(I) (defining "commodity trading advisor" with reference to advice regarding "trading in" contracts "made or to be made on or subject to the rules of a contract market"); 1a(8) (defining "floor broker" as person who "shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market"); 1a(9), (12) & (14) (similar use of term in definition of floor trader, futures commission merchant, and introducing broker); 6a(a) (defining CFTC's obligation to issue rule prohibiting "exces-

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for-physical transactions or "EFPs," are used by parties to simultaneously close out their opposite hedges in futures. A buyer of a cash commodity (*e.g.*, corn, sugar, cocoa, etc.) transfers to the seller a corresponding amount of long futures contracts for that commodity, or receives from the seller a corresponding amount of the short futures for that commodity, at a price difference that is mutually agreed upon. CFTC Glossary, at http://www.cftc.gov/educationcenter/glossary/index.htm. Such exchanges occur "ex-pit" or off the exchange floor.

A second type of "ex-pit" trade is the transfer trade, which involves a book entry by an FCM for the purpose of: (1) transferring existing trades from one customer account to another within the same firm where no change in ownership is involved; or (2) transferring existing trades from the books of one FCM to the books of another FCM where no change in ownership is involved. See *ibid.*

sive speculation" by reference to contracts made "on or subject to the rules of any contract market"); 7a(a)(7) & (12)(A) (contract markets must require that "receipts issued under the United States Warehouse Act shall be accepted in satisfaction of any futures contract, made on or subject to the rules of such contract market" and submit to the CFTC for approval rules "that relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market"); 9 (authorizing the CFTC to issue an order prohibiting person found to have engaged in manipulating prices "from trading on or subject to the rules of any contract market"); 12b (barring person subject to a Section 9 order from causing to be made "any contract for future delivery of any commodity, on or subject to the rules of any contract market").

This lengthy—and not even exhaustive—list demonstrates that when Congress used the phrase "on or subject to the rules of" a contract market, as it did in Section 25(b), it meant to refer to trading. See *FTC* v. *Ken Roberts Co.*, 276 F.3d 583, 590 (D.C. Cir. 2001) (Congress's use of "transactions on contract markets" is "best understood to refer to the actual trading of futures contracts").

***b. "Rules of such contract market or licensed board of trade."*** The version of Section 25(b)(1) that was in effect at the time of the events in this case expressly imposed liability on a "***contract market, clearing organization of a contract market, or licensed board of trade***" that failed to enforce its rules or enforced them in violation of the statute or Commission regulations, but provided a cause of action only to "a person who engaged in any transaction on or subject to the ***rules of such contract market or licensed board of trade***" (emphasis added). 7 U.S.C. § 25(b)(1). The statute conspicuously omits transactions subject to the rules of the "clearing organization of a contract market."

That omission provides important additional evidence that Congress intended to permit only the buyers and sellers of contracts to assert the private cause of action. Those trades

may be accomplished only on or subject to the rules of a contract market or board of trade. Congress did not include transactions "on or subject to the rules of such clearing organizations" because futures trades do not occur "on" clearing organizations, and because traders do not themselves participate in transactions subject to clearing organization rules. That language therefore was not needed to define the scope of the cause of action that Congress sought to create.[15]

Petitioner and the government argue at length that, because the clearing activity in this case supposedly was subject to the rules of the contract market as well as the rules of the clearing organization, petitioner's "transactions" entitle it to invoke the cause of action. That argument misses the point. The question here is what Congress intended by the words it used. Its omission of any reference to "rules of a clearing organization" notwithstanding its reference to "clearing organization" just a few lines earlier in the very same provision, shows that it was not seeking to provide a cause of action for a broad range of plaintiffs, but only intended to cover investors.[16]

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[15] Petitioner apparently realizes the significance of this omission—it repeatedly (and incorrectly) uses the phrase "on or subject to the rules of an exchange or its clearinghouse" (*e.g.*, Br. 3, 21, 22, 24, 25, 27), which is not what the statute said before the 2000 amendments. See also FIA Br. 6-7 (utilizing "on or subject to the rules of a registered entity"—the language inserted into the CEA for the first time by the 2000 amendments adopted after the commencement of this case).

[16] Petitioner and the government also contend that when Congress wrote "rules of a contract market" it meant to encompass the rules of a clearing organization because 17 C.F.R. § 1.41, promulgated in 1976, requires clearing organization rules to be submitted to the CFTC for review by defining "contract market" to include "a clearing organization that clears trades for the contract market." Congress in 1982 should be deemed to have been aware of this administrative interpretation, the argument goes, and therefore meant to include clearing organization rules when it wrote only

***c. "Actual losses that resulted from such transaction."*** The statute restricts the damages that may be recovered under Section 25(b)(1) to the plaintiff's "actual losses that resulted from" the "transaction on or subject to the rules of such contract market or licensed board of trade." Rather than employing the more general phrase "actual damages," Congress inserted the more specific term "actual losses."

To be sure, Congress did use the term "actual damages" in (a)(1) and in (b)(1). However, in (b)(1), Congress explicitly made clear that "actual losses" was a distinct subset of "actual damages." Section 25(b)(1) declares that "any contract market, clearing organization of a contract market, or licensed board of trade * * * shall be liable for actual damages **** * * to the extent of * * * actual losses***" that resulted from the transaction (emphasis added). Congress's use of that narrower phrase indicates that it contemplated recovery of only one specific type of "damages" under this provision—trading losses—as compared with the different types of damages that could be recovered under subsection (a). Especially when coupled with "such transaction," Congress's use of that term therefore provides still more evidence that Congress's intent was to create a cause of action available only to buyers and sellers of futures contracts, and not to non-traders, such as petitioner, that merely cleared such transactions.

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"rules of such contract market." That contention is wrong for three reasons. *First*, Section 1.41(a) expressly states that its definitions apply only "[f]or purposes of this section," and when the CFTC promulgated the regulation it emphasized the limited applicability of the "contract market" definition 41 Fed. Reg. 40091, 40093 (1976). *Second*, the CFTC in June 1982—when Congress was considering the bill that added Section 25(b)—issued an administrative interpretation confirming this limitation on Section 1.41. See CFTC Interpretive Letter 82-5 [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,964 (June 15, 1982). *Third*, under this theory, Congress never would have had to use the term "clearing organization" or its synonyms anywhere in the CEA; yet those terms appear in several provisions, including Section 25(b).

* * * * *

In view of the statute's clear language, it is not surprising that every court to consider the scope of Section 25(b)(1) has concluded that it is available only to traders of futures contracts. See *American Agric. Movement, Inc.* v. *Board of Trade of Chicago*, 977 F.2d 1147, 1153 (7th Cir. 1992) ("By its terms, then, § 22(b) creates the exclusive remedies available to those injured by violations of the CEA, and makes those remedies available only to persons injured in the course of trading on a contract market. It therefore forecloses all other remedies, including any on behalf of non-traders."); *DGM Invs., Inc.* v. *New York Fut. Exch., Inc*, No. 01 Civ. 11602, 2002 WL 31356362, at *2 to *5 (S.D.N.Y. Oct. 17, 2002); *Vitanza* v. *Board of Trade of N.Y., Inc.*, No. 00 CV 7393, 2002 WL 424699, at *4 to * 8 (S.D.N.Y. Mar. 18, 2002); *de Atucha* v. *Commodity Exch., Inc.*, 608 F. Supp. 510, 521-522 (S.D.N.Y. 1985) (Section 25(b) "plainly limits the private remedy to market traders"); see also *Unity House, Inc.* v. *First Commercial Fin. Group*, No. 96C-1716, 1997 WL 701345, at *7 (N.D. Ill. Nov. 5, 1997), *aff'd*, 175 F.3d 1022 (7th Cir. 1999).

No court has adopted the broad rule urged by petitioners.

### 2. *Petitioner's interpretation of Section 25(b)(1) cannot be reconciled with the language Congress chose.*

Petitioner advances three arguments in support of its contention that the private cause of action extends broadly to any person who engages in any activity that is in any way governed by the rules of a contract market or clearing organization. None of those arguments provides any basis for rejecting the interpretation of the statute based on its plain meaning.

*First*, petitioner relies principally (Br. 27-28) on the asserted breadth of the phrase "any transaction" standing alone, but its argument totally ignores the manner in which Congress used the term "transaction" in the statute and—even

more importantly—the limiting language with which Congress surrounded that term in Section 25(b)(1). In particular, the words "any transaction" are followed by "on or subject to the rules of" a contract market, a phrase that has a specific meaning in the CEA. See pages 22-25, *supra*. This Court has repeatedly rejected statutory construction arguments that rest on wrenching critical language out of its statutory context. *E.g.*, *Jones* v. *United States*, 527 U.S. 373, 389 (1999). It should reject petitioner's argument for the same reason.

*Second*, petitioner claims (Br. 28) that Congress's decision not to use the phrase "purchased or sold" in defining the class of persons entitled to sue under Section 25(b)(1)—when it used that phrase in Section 25(a)(1)(D)—shows that Congress intended to make the cause of action available to a broader class of plaintiffs. But the latter provision was referring to a specific category of transactions: purchases or sales of contracts referred to in subparagraph (B) "if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract." 7 U.S.C. § 25(a)(1)(D). It would have been awkward and unnatural for Congress to use the word "transaction" there when it was trying to accomplish three things—refer back to subparagraph (B), which uses the term "contract"; identify the person entitled to sue; and limit the claims to those involving manipulation of the price of the same contract or the same underlying commodity as the contract or commodity that the plaintiff traded.

Using "transaction" would have made the sentence much more convoluted. For example: "who engaged in a transaction on or subject to the rules of a contract market with respect to a contract referred to in subparagraph (B) hereof if the violation * * *." Not surprisingly, Congress used a phrase imposing the same limitation as "transaction on or subject to the rules of a contract market"—"purchased or sold a contract referred to in subparagraph (B)"—that permitted a much simpler sentence structure in view of the context. 7 U.S.C. § 25(a)(1)(D). In Section 25(b)(1), by contrast,

where there was no definition of contract in an earlier subparagraph for Congress to refer to, and there was no need to define a specific type of violation, Congress could express its intent through the more generic words that it employed elsewhere in the statute.

*Third*, petitioner claims (Br. 32-33) that Section 6(a) of title 7 supports its broad reading of Section 25(b)(1). But Section 6(a) actually supports our construction of the statute.

Section 6(a) prohibits offering, entering into, executing, confirming the execution of, soliciting, or accepting any order for, or otherwise dealing in "any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery." Petitioner contends (Br. 32-33) that this prohibition encompasses clearing, that the authorization of prohibited activities in Section 6(a)(1) when "such transaction is conducted on or subject to the rules of a" contract market must encompass clearing activities in order to override the prohibition against clearing, and that the similar "transaction * * * conducted on or subject to the rules of" language in Section 25(b)(1) accordingly encompasses clearing activities as well. The argument fails because petitioner is wrong in asserting that the prohibitory language encompasses clearing activities.

All of the activities prohibited by Section 6(a)—offering, entering into, executing, confirming execution, soliciting, accepting, and otherwise dealing in futures contract transactions—occur as part of the futures trade itself. Offer, solicitation and acceptance are elements of every trade, execution is specifically defined as trading in the statutory definitions of floor broker and floor trader (7 U.S.C. §§ 1a(8) & 1a(9)), and "otherwise dealing in" these transactions similarly references trading activity. By contrast, clearing takes place only after the trade is completed. See pages 6-10, *supra*. See also pages 40-41, *infra*.

Moreover, the term "clearing" is conspicuously absent from Section 6(a)'s list of prohibited activities even though

the clearing function is referenced elsewhere in the statute. See, *e.g.*, 7 U.S.C. § 6d(2). That omission is fatal to petitioner's argument.

Petitioner places considerable emphasis on the presence of "in connection with" in Section 6(a)'s prohibitory language. But that phrase does not bring clearing within the scope of Section 6(a)'s prohibition.

The purpose of the prohibitory language at the beginning of Section 6(a) is to reach the entire class of transactions that Congress wished to be conducted "on or subject to the rules of" a contract market. That included not simply futures contracts themselves, but also options on futures contracts and other instruments relating to futures contracts. See 7 U.S.C. § 2(i) (referring to "any transaction which is of the character of, or is commonly known to the trade as, an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty'" in defining the CFTC's jurisdiction). The obvious purpose of the "in connection with" language was to ensure that the prohibition would reach options as well as other agreements that were the subject of trading on futures markets—simply referring to "any transaction in * * * a contract for the purchase or sale of a commodity for future delivery" would not fulfill that goal.[17]

If petitioner's argument were correct, moreover, Congress would not have had to enact specific provisions barring unregistered persons from "engag[ing] as futures commission merchant or introducing broker in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery" (7 U.S.C. § 6d) and barring unregistered per-

[17] Congress could not utilize Section 2's list of transactions in Section 6(a) because combining those nine terms with Section 6(a)'s list of prohibited actions would have produced an unwieldy provision. And it could not have referred to "transactions on or subject to the rules of" a contract market, because that would have made the prohibition identical to the authorization in Section 6(a)(1), and provided no guidance with respect to the scope of the prohibition.

sons from "act[ing] as floor trader in executing purchases and sales, or as floor broker in executing any orders for the purchase or sale of any commodity for future delivery" (*id.* § 6e). All of those activities already would be impermissible under petitioner's broad view of the Section 6(a) prohibition. Congress's decision to enact these provisions demonstrates conclusively that the Section 6(a) prohibition does not have the broad reach ascribed to it by petitioner.

Because Section 6(a)'s prohibition reaches only futures and options trading, the phrase "transaction * * * conducted on or subject to the rules of" a contract market in Section 6(a)(1) also refers only to traders' purchases and sales of future contracts and options. Far from supporting petitioner's approach, therefore, Section 6(a)(1) confirms that the similar language of Section 25(b)(1) also is limited to trading.

Petitioner also asserts (Br. 33-34) that Congress's separate use in Section 6(a)(1)-(3) of the words "transaction" and "contract" demonstrates that "any transaction" in Section 25(b) encompasses more than trading of futures contracts. But petitioner's argument ignores that fact that Congress used these two words to describe different concepts. Section 6(a) uses "transaction" to refer to trading; the phrase "contract for the purchase or sale of a commodity for future delivery" refers to the contracts that are the subject of the trades. Thus, the trading of futures contracts must be "conducted on or subject to the rules of a contract market"; the contracts themselves must be "executed or consummated by or through a member of such contract market." 7 U.S.C. § 6(a)(1) & (2). Petitioner is simply wrong in arguing that Congress's use of the two phrases supports its interpretation of Section 25(b)(1).

The government does not endorse any of petitioner's statutory construction arguments. It instead proposes (Br. 20) a "plain language" argument different than those presented by petitioner. The government asserts that a buyer or seller of futures contracts could not consummate its trade without the assistance provided by petitioner, and that petitioner

therefore is "an entity that 'engaged in' the relevant transactions." The government relies heavily on the dictionary definition of "engage in," claiming that it reaches broadly to encompass entities such as clearing members.

The flaw in the government's argument is that it analyzes the meaning of "engaged in" without considering the words that surround it. As we have discussed, the plain language of Section 25(b)(1) refers to traders' purchases and sales of futures contracts and options, not the subsequent clearing of those transactions. The statute and NYCC rules make clear that the trade itself "on or subject to the rules of" the contract market is distinct from the clearing of that trade. The trade, according to the statutory definitions of floor trader and floor broker, occurs on the floor of the exchange. And the NYCC rules expressly recognize that the contract is made prior to initiation of the clearing process. See pages 6-10, *supra*. See also pages 40-41, *infra*.

A clearing member may perform an activity that is ***related*** to the trade, but it is not ***the transaction*** to which Section 25(b)(1) refers. The trade occurs ***before*** it is cleared. It is not possible to engage in a transaction ***after*** the transaction has occurred. Including as part of a "transaction" any post-contract activity that aided in consummating a transaction would reach broadly, for example to the banks that transfer required payments or to the technology companies that provide necessary hardware and software.[18]

Because petitioner did not engage in the trades themselves, the only relevant question under Section 25(b)(1) is whether the clearing of the trades—the separate activity in which petitioner did engage—was "any transaction on or subject to the rules" of a contract market. What the govern-

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[18] The government rests its contrary view in part (Br. 20-21) on its view of the role that an FCM plays forming the agreement on the floor of the exchange. But Klein did not perform that role here; it acted solely as First West's clearing member. See pages 12-14, *supra*.

ment obscures by focusing on petitioner's "essential role" (Br. 20) is that the only relevant question for statutory construction purposes is whether petitioner's clearing activity was "any transaction on or subject to the rules" of a contract market. The government's argument thus depends on the same flawed assumption as petitioner's position: that the term "any transaction on or subject to the rules of such contract market" refers to any activity that is subject to contract market or clearing organization rules.

When Congress sought to reach beyond trading of futures contracts and include ancillary activities, it did so explicitly by employing language different than "transactions on or subject to the rules of" a contract market. Thus, in prohibiting individuals from falsely representing themselves as contract market members, Congress barred such false representations "in connection with the handling" of "any order or contract for the purchase or sale of any commodity in interstate commerce or for future delivery." 7 U.S.C. § 6h.

Similarly, in Section 25(a)(1) Congress created a private action for damages resulting from violations of the Act in favor of a person "who made ***through*** [the defendant] any contract of sale of any commodity for future delivery" and "who purchased from or sold to [the defendant] or ***placed through [the defendant]*** an order for the purchase or sale of" specified types of futures contracts (emphasis added). Paragraph 3 of Section 25(a) makes clear that the reason for this language is to reach "violation[s] in the execution of an order on the floor of . contract market."

Congress thus knew how to write more broadly when it wanted to target the activities of brokers and FCMs in facilitating trades of futures contracts. But it did not include similarly broad language bringing clearing or other non-trading activities within the scope of Section 25(b)(1).[19]

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[19] The government (Br. 21) places considerable emphasis on Klein's agreement with Eisler guaranteeing that Klein act as a clearing memember for Eisler's trades (under NYFE Rule 121

In sum, the arguments advanced by petitioner and its amici simply do not provide any basis for ignoring the plain meaning of the words Congress used in Section 25(b)(1). Moreover, as we next discuss, the legal background and legislative history confirm that Congress intended to make the private action available only to investors.

### B. The Legal Background Against Which Congress Legislated Confirms That The Private Action Is Available Only To Investors.

Congress enacted Section 25(b)(1) shortly after this Court held in *Curran* that the 1974 amendments to the CEA did not eliminate the private cause of action that courts had implied under the Act before adoption of those amendments. The *Curran* Court summarized its conclusion by stating, "[w]e hold that the private cause of action under the CEA that was previously available to ***investors*** survived the 1974 amendments." *Curran*, 456 U.S. at 388 (emphasis added).

The Court's opinion consistently focused on traders and investors as the parties eligible to invoke the cause of action. See *id.* at 389 ("***purchasers or sellers*** of futures contracts—whether they be pure speculators or hedgers—[were] necessarily * * * protected by [the antifraud provision of the CEA]") (emphasis added); *ibid.* ("We are satisfied that ***purchasers and sellers*** of futures contracts have standing to assert both [fraud and manipulation] claims") (emphasis added); *id.* at 390 ("The [1974] legislative history quite clearly indicates that Congress intended to protect all ***futures traders*** from price manipulation and other fraudulent conduct violative of the statute * * * [as] legislation regulating future

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(Pet. Br. App. 9a-10a)). But Klein's obligation to pay margin to NYCC arose from its role as clearing member for First West, not because of its separate promise to act as clearing member of last resort for Eisler's trades. See pages 7-8, *supra*. The guarantee simply is not relevant in this case.

trading was for the 'especial benefit' of futures traders") (emphasis added).

Acting against that backdrop, Congress would have made clear any intent to expand the cause of action beyond the bounds indicated in *Curran*. Not only is there no such indication in Section 25(b)(1), but Congress plainly chose statutory language consistent with the *Curran* Court's focus on a cause of action for investors—employing the phrase ("on or subject to the rules of" a contract market) used repeatedly in the CEA to reference futures trading.

Petitioner attempts to blunt the impact of *Curran* by arguing that the cause of action recognized there extended to claims by clearing members against clearing organizations and contract markets. Petitioner is wrong about the scope of *Curran* and—even more importantly—it is wrong about the way Congress would have perceived the Court's decision.

Petitioner first asserts (Br. 41-42) that the fact that one of the plaintiffs in *Curran* was an FCM shows that Congress intended to extend the Section 25(b)(1) private action to FCMs claiming injury with respect to clearing activities. But the plaintiff to which petitioner refers—Incomco—was engaged in trading for its own account, not on behalf of its customers.[20] In that situation, of course, the FCM *is* the investor, and therefore may invoke the cause of action on that basis. Those facts therefore say nothing about whether a clearing member

[20] The court of appeals' description of Incomco's trading activities makes this plain: "***All the plaintiffs*** invested heavily on the long side of the May contract. In addition, Incomco developed a position in the cash market. It had accepted 1,500,000 pounds of Maine potatoes delivered to it pursuant to the March futures contract, and planned to sell these potatoes to those short the May contract who needed supplies to satisfy their delivery obligations. Anticipating a cash market shortage, Incomco expected to sell its potatoes at a handsome premium." *Leist* v. *Simplot*, 638 F.2d 283, 291 (2d Cir. 1980) (emphasis added), *aff'd sub nom.*, *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353 (1982).

is entitled to sue on the basis of its actions in clearing the trades of one of its customers.

Petitioner also points (Br. 41) to *Seligson* v. *New York Produce Exch.*, 378 F. Supp. 1076 (S.D.N.Y. 1974), a district court decision recognizing an implied private right of action under the CEA for brokers against exchanges. Based on the fact that this one decision was included in a list of cases cited in a footnote in *Curran* (456 U.S. at 392 n.94), petitioner reasons that Congress must have intended to permit clearing members to sue when it codified that private right of action in the wake of *Curran*.

This single decision, which addresses the extension of the cause of action to FCMs in a single paragraph (378 F. Supp. at 1084), is too slender a reed on which to premise an expansive interpretation of the express cause of action created by Congress. Cf. *F. Hoffman-LaRoche Ltd.* v. *Empagran S.A.*, 542 U.S. 155, 172-173 (2004) (rejecting argument that statute should be construed by reference to single decision that pre-dated congressional action: "[w]e do not see how Congress could have taken this case as significant support for the proposition that the Sherman Act applies in present circumstances").

The Court included *Seligson* in a footnote that lists ten decisions that "drew no distinction between an action ***against*** a broker and an action against an exchange." 456 U.S. at 391-392 & n.94 (emphasis added). The Court's citation of *Seligson* for that proposition provides no indication that the Court meant to endorse the extension of the implied cause of action to claims by non-traders such as brokers or clearing members.

Moreover, there is no basis whatever to believe that Congress would have understood *Curran* to encompass claims by plaintiffs other than investors. Congress would have focused on the language used by the Court in the text of its opinion—language that repeatedly focuses on investors.

The way Congress wrote Section 25(b)(1) evidences no intent to create a cause of action broader than the one described in *Curran*. Rather, Congress's use of a phrase—"any transaction on or subject to the rules of" a contract market—that it consistently employed to refer to purchases and sales of futures contracts and options, viewed in light of the legal context that Congress confronted, can only be construed as embodying the cause of action for "investors" discussed by the Court in *Curran*.

### C. The Legislative History Of Section 25(b)(1) Demonstrates That Congress Intended To Create A Cause Of Action For Investors.

The legislative history of Section 25(b) provides still more support for the conclusion that the cause of action is limited to traders of futures contracts and options. When Rep. Dan Glickman, Chairman of the House Subcommittee on Wheat, Soybean and Feed Grains, proposed the amendments that became Section 25(b), he observed that "[t]he amendments would * * * allow commodity ***investors*** who suffer actual damages the right to sue both brokers and exchanges" for CEA violations. H.R. Rep. No. 97-565, part I, at 239 (1982) (emphasis added).

Congress's single-minded focus on protecting investors—the buyers and sellers of futures contracts and options—is evident throughout Section 25(b)'s legislative history. See, *e.g.*, H.R. Rep. No. 97-565, part I, at 240 ("***investors*** in futures markets will face potentially greater and greater uncertainty and risk") (emphasis added); *id.* at 57 (the "cause of action in these cases would be restricted to cases where the plaintiff had engaged in a regulated commodity transaction and could show that there was bad faith in failing to take the necessary action").

That focus is not surprising because Congress viewed *Curran* as recognizing a cause of action for investors in fu-

tures contracts. The Conference Committee Report described *Curran* as holding

> that implied private rights of action exist under the Commodity Exchange Act in cases brought by an investor against his futures commission merchant for violation of an antifraud provision of the Commodity Exchange Act, and by speculators in futures contracts against a contract market and its officials and against futures commission merchants or other market participants claiming damages resulting from unlawful price manipulation that allegedly could have been prevented by the exchange's enforcement of its own rules.

H.R. Conf. Rep. No. 97-967, at 53 (1982); see also S. REP. NO. 97-495, at 51 (1982) (describing *Curran* as finding "that ***purchasers and sellers*** of futures contracts have standing" and summarizing *Curran* as a case that "will allow actions * * * by commodity ***customers***" to be brought in federal district courts, "rather than proceeding in the Reparations Section of the CFTC") (emphasis added). The then-Chairman of the CFTC similarly described the decision in *Curran* as one where the Court found that "***purchasers and sellers***" of futures contracts have standing.[21]

There is no hint in the legislative history of any intent to extend the private action beyond the class of plaintiffs identified by the Court in *Curran*. The government, for example, points (Br. 28) to a reference to a "'regulated commodity transaction,'" but that phrase is a perfect description of futures and options trades. The legislative history too, therefore, weighs against petitioner's construction of Section 25(b).

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[21] *SEC/CFTC Jurisdictional Issues and Oversight, Part 1: Hearings Before the H. Subcomm. On Telecommc'ns, Consumer Prot., and Fin. and H. Subcomm. on Oversight and Investigations*, 97th Cong. 208 (1982) (emphasis added).

### D. The NYCC And NYFE Rules Confirm That Clearing Members Do Not Engage In Transactions "On Or Subject To The Rules Of" A Contract Market.

Klein acknowledged in its complaint that it did not purchase or sell any P-Tech futures or options for its own account. It alleged that the trades executed for First West's account were "unsolicited trades," made "without input, counsel, advice or any type of recommendation whatsoever" from petitioner, and that Klein "had no equity or financial interest in the First West account nor did Klein exercise control over the trading in said account." J.A. 17 (¶¶ 56-57). Because petitioner was not engaged in buying or selling futures—but rather was acting solely as a clearing member in clearing First West's trades—petitioner is not entitled to invoke the private action created in Section 25(b).

The NYCC Bylaws and Rules themselves establish that the clearing process occurs *following* the transaction "on or subject to the rules of" the contract market. "Clearing member" is defined as a person who may clear "Contracts effected on or subject to the rules of an Exchange" (NYCC Bylaw 1.1 (J.A. 94), demonstrating that the contract has already been made before the clearing process begins. That description, of course, accords with the CEA's description of floor brokers and floor traders as the persons who effect purchase and sales on or subject to the rules of a contract market. See page 24, *supra*; see also U.S. Br. 5-6 (acknowledging that clearing process occurs after the buyer-seller contract is formed); S. Rep. No. 97-384, at 187 (1982) (stating that "[t]he actual trading of futures contracts takes place in the noisy, boisterous setting of an auction-type market"); *id.* at 188 (clearing process occurs "[a]fter a trade has been executed").

Perhaps recognizing that its status as a clearing member places it outside the congressionally-protected class, petitioner in this Court for the first time invokes NYFE Rule 306(i)(2), asserting (Br. 24) that the rule's statement that a

contract "shall be made on behalf of a clearing member who shall be the buyer or seller of said contract" renders petitioner the buyer or seller of the P-Tech futures contracts and options.

As a threshold matter, an exchange rule cannot change the scope of a federal statute. Congress's determination that the cause of action extends only to investors cannot be overridden by a rule declaring that a clearing member that clears a contract thereby becomes the buyer or seller for purposes of Section 25(b). Clearing members perform an important role (see pages 6-9, *supra*), but clearing a trade does not place the clearing member in the same position as the buyer or seller. Indeed, NYCC Rule 401 (Resp. App. 6a-7a) makes clear that the clearing member's assumption of the buyer-seller contract is extremely brief: once the contract is cleared, the clearing members' "liabilities and obligations" under that contract are "terminate[d]." See pages 7-8, *supra*. The clearing member's obligations then flow from the NYCC rules, not from the contract formed on the floor of the exchange.[22]

Moreover, the text of Rule 306(i)(2) taken as a whole does not have the meaning ascribed to it by petitioner. The first sentence of the provision states that "[e]very contract made on the Exchange ***shall be assumed by a [clearing]***

[22] As respondents demonstrated in their opposition to the petition, the decisions relied upon by petitioner to suggest that clearing members, like petitioner, were principals to such transactions are not to the contrary. See Br. in Opp. 9-10. First, as *Leist* makes clear, FCMs are treated "as if" they were principals, recognizing that they were *not* the actual principals. 638 F.2d at 286-287. Second, with respect to *Bernstein* v. *Lind-Waldock & Co.*, 738 F.2d 179 (7th Cir. 1984), it is important to note that in addition to relying on *Leist* for a "more detailed description of commodities trading," (*id.* at 181) it also concerned trading in Chicago. As noted above (see note 3, *supra*), there are significant differences between trading rules in Chicago and in New York. Thus, *Bernstein's* description of the Chicago market mechanics is inapposite here.

***member***" (emphasis added). The sentence following the one on which petitioner relies says that "[t]he clearing member ***shall assume said contract in writing within one hour*** after receipt of a report from the trading member identifying the terms thereof" (emphasis added). Pet. Br. App. 14a. These two sentences thus recognize–consistent with the NYCC Bylaws—that the contract is made prior to the clearing process.[23]

Petitioner's view that the second sentence of the rule (that a contract "shall be made on behalf of a clearing member who shall be the buyer or seller of said contract") establishes that the clearing member is a party to the trade, is squarely inconsistent with the other two sentences of the provision as well as with the NYCC Bylaws. The sentence on which petitioner relies therefore is most logically read to refer to the clearing members' agency relationships with their customers—that one clearing member must act for the buyer and another for the seller.

Because a contract must be made before it can be assumed by another, the only way to give meaning to all three sentences is to conclude that a contract made on the Exchange between the buyer and seller is then assumed by the clearing members, who (by virtue of the second sentence) must be identified by the floor brokers within some period of time after the transaction is executed. The rule does not and cannot confer the status that Congress established as the precondition for invoking the Section 25(b)(1) cause of action.

### E. Petitioner's Construction Of Section 25(b)(1) Would Produce Absurd Results.

The meaning of Section 25(b)(1) propounded by petitioner should be rejected for the additional reason that it

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[23] The TIPS automated process confirms this conclusion, because the trade data is input into the system in order to initiate the clearing process, making clear that the trade is complete before the clearing process begins. See note 6, *supra*.

would produce an interpretation of the statute plainly inconsistent with Congress's aim.

*First*, if the Court were to accept petitioner's contention that "on or subject to the rules of" a contract market reaches any interaction regulated by contract market rules, the other provisions of the CEA that use that phrase would apply much more broadly. Section 6i's requirements governing transactions in excess of trading limits would apply to clearing and other activities; the statutory definitions of "floor broker" and "floor trader" would encompass a wider variety of transactions than floor trades, and the CFTC would be obliged to expand the reach of its rules prohibiting "excessive speculation." See pages 24-25, *supra*.

*Second*, petitioner's approach would substantially vitiate the cause of action available to investors—the principal focus of Congress's concern. Thus, petitioner argues (Br. 31 n.14) that customers "are prohibited by Congress, the CFTC, and respondents' own rules from engaging directly in transactions *on* the exchange." It asserts that the "transaction" entitling investors to invoke Section 25(b)(1) is the transaction between the customer and the FCM, which, according to petitioner, is "subject to the rules" of a contract market.

But Section 25(b)(1) limits recoverable damages to "actual losses that resulted from" the transaction that is on or subject to the rules of contract market. The statute thus requires a causal connection between the actual losses and the transaction that is the basis of the suit. If a customer suffers trading losses as a result of a contract market's failure to enforce rules, it would be difficult to argue that such losses "resulted from" the customer's relationship with the FCM. See page 5, *infra*.

Under petitioner's reading of the statute, therefore, the party that Congress most clearly sought to protect—the customer directly investing in the futures markets—would be left without the ability to recover trading losses caused by an

exchange's failure to enforce its rules, even though such losses were at the forefront of Congress's concern.

If, on the other hand, investors retain the ability to recover losses predicated on their exchange trades, allowing non-traders (such as petitioner) to recover will produce a significant risk—even a certainty—of multiple recoveries. Any trade of futures contracts would subject a contract market or clearing organization to potential claims by the investor, the FCM, the floor broker, the introducing broker (see 7 U.S.C. § 1a(8)), the commodity trading advisor (see *id.* § 1a(5)), and commodity pool operator (see *id.* § 1a(4)), all of whom like clearing members can claim to be "essential" participants in futures and options trades and most of whom participate in trades that are not proprietary trades by a contract market member. (The government recognizes (Br. 24 n.13) that this will be the result of its approach.) These multiple claims, which would become routine, inevitably would produce duplicative recoveries.

This Court repeatedly has refused to construe federal statutes in a manner that will subject a defendant to multiple liability. See *Holmes* v. *Securities Investor Protection Corp.*, 503 U.S. 258, 287 (1992); *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720 (1977). It should reject that approach in this context as well.

*Fourth*, the structure of Section 25 indicates that Congress intended to limit the liability of contract markets and clearing organizations. Thus, the private cause of action created in Section 25(a)—which excludes claims against contract markets, clearing organizations, and their officers and directors—supplements the administrative action for recovery of actual damages set forth in Section 18 and the remedies that Section 7a(11) required contract markets to create. See 7 U.S.C. § 25(a)(2) ("the rights of action authorized by this subsection ***and by sections 7a(11), 18, and 21b(10) of this title*** shall be the exclusive remedies * * *") (emphasis added).

The private action against a contract market and its officers and directors, by contrast, is "the exclusive remedy under this chapter available to any person who sustains a loss as a result of" a contract market's enforcement of its rules in violation of the Act. 7 U.S.C. § 25(b)(5). Neither the administrative action nor the remedies created by contract markets' rules extend to such claims.

Moreover, a claim under subsection (a) is available only to persons who participated in one of four specified transactions—some of which plainly are not transactions "on or subject to the rules of" a contract market—a standard that also applies to claims against the officers and directors of contract markets and clearing organizations. 7 U.S.C. § 25(b)(3). Contract markets and clearing organizations, by contrast, are subject to suit only by a person who engaged in a transaction "on or subject to the rules of" a contract market.

Under petitioner's theory, however, the liability of contract markets and clearing organizations would be extremely broad—extending to any damages related to any activity that is in any way subject to the contract market's rules. That result is sharply inconsistent with the statutory design. That could open the door to Section 25(b) lawsuits involving membership issues (on the ground that membership is a "transaction"), administration of financial requirements, indeed, virtually any interaction between a contract market or clearing organizations and any other person or entity. That would threaten to impose a crippling financial burden on contract markets and clearing organization given the millions of interactions that take place each year—plainly the result that Congress sought to avoid by sharply circumscribing their liability.

Finally, contrary to the assertions of petitioner (Br. 42) and the Futures Industry Association (Br. 11), the integrity of the futures markets will not be threatened by interpreting Section 25(b)(1) in accord with Congress's intent. The principal safeguard of the proper functioning of the markets is the

CFTC's expansive enforcement authority, which extends broadly to contract markets and clearing organizations and their officers and employees. See 7 U.S.C. §§ 12a, 12c, 13a. The CFTC has broad authority to issue cease and desist orders, impose fines, bar individuals or entities from engaging in any regulated activity, and issue orders requiring contract markets to remedy deficiencies. *Id.* §§ 9, 9a, 12e, 13, 15.

The assertion that a broad interpretation of Section 25(b)(1) would play a critical role in deterring wrongful conduct is undercut by petitioner's inability to point to a single example of a decision upholding a claim by anyone other than an investor in the 24 years since the statute was enacted. Moreover, in the five years that have elapsed since the New York federal district courts dismissed each of the three lawsuits arising out of petitioner's collapse, the futures markets have grown substantially. Some commodity and futures exchanges have become public companies. Others have been acquired by or merged with public companies. These developments make clear that there is no reason whatever to believe that confidence in these markets would be affected adversely by a decision affirming the dismissal of these claims.

## II. PETITIONER HAS NOT ALLEGED "ACTUAL LOSSES THAT RESULTED FROM" ITS TRANSACTIONS AND WERE CAUSED BY RESPONDENTS' FAILURE TO ENFORCE THEIR RULES.

If the Court accepts petitioner's invitation to expand substantially the scope of Section 25(b)(1) to encompass claims by non-traders, the Court should decide whether harm such as that allegedly suffered by petitioner has a sufficiently close causal connection to respondents' alleged misconduct and to the damages that petitioner claims to have suffered to give petitioner standing to maintain this action. Broadening the scope of the cause of action will open the door to many more lawsuits; clear guidance from this Court regarding the statutory causation requirement will help the lower courts weed out remote claims.

The courts below clearly understood that petitioner's alleged damages were too remote to satisfy the strict causation standard that Congress specified. This Court should so rule, and affirm the judgment of the court of appeals on that basis.

Section 25(b)(1) authorizes recovery of "actual damages sustained by a person who engaged in any transaction on or subject to the rules of" a contract market but only "to the extent of such person's actual losses that resulted from such transaction and were caused by" the contract market's failure to enforce its rules. Both courts below found that petitioner's claim failed to satisfy this standard.

The court of appeals stated:

> [R]egardless of whether the First West trading position rose or declined in value, Klein had no interest in any of the resulting profits or investments losses. As the district court observed, "Klein suffered damages because of its customer First West's inability to cover its margin call. . . ." Thus, Klein's loss was a credit loss, not a trading loss.

Pet. App. 12a (internal citation omitted). The district court not only described First West's inability to cover its margin call as being the cause of Klein's alleged damages, it also observed, "[q]uite simply, [Klein] did not suffer its damages in the course of its trading activities on a contract market." *Id.* at 25a. That determination is correct and should be upheld by this Court.[24]

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[24] Respondents argued below that petitioner "suffered no investment loss whatsoever as a result of the decline in value of First West's positions. [Petitioner's] only connection to 'transactions in a contract market' was entirely secondary." Brief for the NYBOT Defendants-Appellees-Cross-Appellants, 2005 WL 5352926, at *21 (July 25, 2005). And respondents raised the issue in their brief in opposition (at 6): "Customer credit losses sustained by a broker are simply not losses arising from exchange transactions as described by CEA § 22. The losses Petitioner seeks to recover were

### A. Section 25(b)(1) Requires A Close Link Between The Transaction, The Plaintiff's "Actual Losses," And An Exchange's Failure To Enforce Its Rules.

This Court has consistently held that language similar to that included in Section 25(b)(1) imposes a strict proximate cause requirement. See, *e.g.*, *Holmes*, 503 U.S. at 271 (construing the RICO statute to embody the "general tendency of the law, in regard to damages at least, is not to go beyond the first step"); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977).[25]

*Holmes* provides a particularly strong analogy. The case arose out of an alleged stock-manipulation scheme that harmed two broker-dealers who, because of losses attributable to the alleged manipulation, could not satisfy their obligations to their respective customers. The failure of the broker-dealers triggered Security Investor Protection Corporation's (SIPC's) obligations under the Securities Investor Protection Act of 1970 to advance funds to reimburse the customers of the failed broker-dealers.

After reimbursing those customers, SIPC commenced an action against the alleged manipulators, asserting claims under RICO (18 U.S.C. § 1964(c)), and sought to be reimbursed for the funds paid to the customers. Notwithstanding

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caused by First West's failure to pay Petitioner the margin debts that it owed to Petitioner under its customer agreement." The proximate cause issue has thus been raised repeatedly at every stage of litigation in this proceeding, and it animated the decisions of the courts below.

[25] To be sure, Congress can mandate damage awards for all injuries caused by unlawful conduct. But the Court has "insist[ed] upon a clear expression of a congressional purpose" before attributing such an intent to Congress. *Brunswick Corp.*, 429 U.S. at 488. Section 25(b) manifests Congress's intent to strictly limit recoverable damages.

its allegations of "but for causation," and despite the fact that RICO conferred standing on "[a]ny person injured in his business or property," this Court held that SIPC's allegations did not fit within the terms of the statute. 503 U.S. at 265.

The Court determined that even if SIPC was assumed to stand in the shoes of the broker-dealers' customers, its injury was too remote because "the conspirators have allegedly injured these customers only insofar as the stock manipulation first injured the broker-dealers and left them without the wherewithal to pay customers' claims." 503 U.S. at 271. The same attenuated causation chain would be impermissible under the strict "actual loss" standard of Section 25(b)(1).

### B. Petitioner's Claim Of Damages For The Collapse Of Its Business Fails To Satisfy The "Actual Loss" Standard.

Petitioner alleges that it was injured when its business collapsed in the wake of First West's failure to provide additional margin. It seeks damages resulting from the collapse of its business.

Thus, petitioner alleges that, "[a]s a direct result of the actions of the defendants, on May 16, 2000, Klein & Co. ceased to operate as a FCM, closed its offices, terminated its employees and commenced to wind up its business, which ceased to operate as of the close of business May 15, 2000." J.A. 28 (¶ 116); see also J.A. 39 (¶ 156). Its complaint seeks recovery of $25 million in compensatory damages. J.A. 54-57.

Petitioner's alleged damages resulting from the collapse of its business are not "actual losses that resulted from" any transaction in which petitioner "engaged" "on or subject to the rules of [a] contract market." Rather they are a classic example of consequential damages that are not recoverable under a strict proximate cause standard. *Associated Gen. Contractors of Cal., Inc.* v. *Carpenters*, 459 U.S. 519, 540, 545 (1983) (holding allegations of "consequential harm" insuffi-

cient as a matter of law by reference to the "indirectness of the injury"—the fact that the chain of causation between the injury and the alleged conduct by defendants "contains several somewhat vaguely defined links").

Indeed, the government appears skeptical that Section 25(b)(1)'s "actual loss" standard permits recovery of damages relating to the collapse of petitioner's business. It says that "petitioner's claims of pecuniary injury cannot be dismissed as speculative" because "petitioner's [NYCC] margin account deficit was approximately $4.5 million" (Br. 17) and declines to express a view on petitioner's damages claim based on the collapse of its business (Br. 29 n.17).

But the margin deficit cannot satisfy the "actual losses" requirement for the simple reason that the complaint does not seek recovery of the margin deficit. Not a single damages allegation refers to this amount.

That omission of such an allegation is intentional, because petitioner did not bear the financial burden of the margin deficit; $4.5 million was paid to Klein's customers by respondent NYBOT, which is now suing petitioner as the assignee of those customers to recover that amount from Klein. See page 15, *supra*. The record thus demonstrates that petitioner never paid one dollar of the loss on which the Solicitor General predicates petitioner's standing. The absence of such an allegation establishes that petitioner cannot satisfy Section 25(b)'s "actual losses" requirement.

## CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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# APPENDIX

## APPENDIX

The relevant provision of the Commodity Exchange Act, 7 U.S.C. § 25 (1994), as in effect when this case was filed in July 2000, provides:

### § 25. Private rights of action

(a) Actual damages; actionable transactions; exclusive remedy

(1) Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to insubparagraphs (A) through (D) of this paragraph and caused by such violation to any other person--

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of—

(i) an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

(2) Except as provided in subsection (b) of this section, the rights of action authorized by this subsection and by sections 7a(11), 18, and 21(b)(10) of this title shall be the exclusive remedies under this chapter available to any person who sustains loss as a result of any alleged violation of this chapter. Nothing in this subsection shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims under this section, including arbitration.

(3) In any action arising from a violation in the execution of an order on the floor of a contract market, the person referred to in paragraph (1) shall be liable for—

(A) actual damages proximately caused by such violation. If an award of actual damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under sections 2, 2a, and 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award; and

(B) where the violation is willful and intentional, punitive or exemplary damages equal to no more than two times the amount of such actual damages. If an

award of punitive or exemplary damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under section 2, 2a, and 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award if the floor broker fails to do so, except that such requirement shall apply to the futures commission merchant only if it willfully and intentionally selected the floor broker with the intent to assist or facilitate the floor broker's violation.

(b) Liabilities of organizations and individuals; bad faith requirement; exclusive remedy

(1) (A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by section 7a(9) of this title, (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or (C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this chapter or any Commission rule, regulation, or order, shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

(2) A registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title or in enforcing any such bylaw or rule violates this

chapter or any Commission rule, regulation, or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule.

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a contract market, clearing organization, licensed board of trade, or a registered futures association willfully aids, abets, counsels, induces, or procures any failure by any such entity to enforce (or any violation of the chapter in enforcing) any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, shall be liable for actual damages sustained by a person who engaged in any transaction specified in subsection (a) of this section on, or subject to the rules of, such contract market, licensed board of trade or, in the case of an officer, director, governor, committee member, or employee of a registered futures association, any transaction specified in subsection (a) of this section, in either case to the extent of such person's actual losses that resulted from such transaction and were caused by such failure or violation.

(4) A person seeking to enforce liability under this section must establish that the contract market, licensed board of trade, clearing organization, registered futures association, officer, director, governor, committee member, or employee acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss.

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this chapter available to any person who sustains a loss as a result of (A) the al-

leged failure by a contract market, licensed board of trade, clearing organization, or registered futures association or by any officer, director, governor, committee member, or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution referred to in this subsection that is alleged to have violated this chapter, or any Commission rule, regulation, or order.

(c) Jurisdiction; statute of limitations; venue; process

The United States district courts shall have exclusive jurisdiction of actions brought under this section. Any such action shall be brought not later than two years after the date the cause of action arises. Any action brought under subsection (a) of this section may be brought in any judicial district wherein the defendant is found, resides, or transacts business, or in the judicial district wherein any act or transaction constituting the violation occurs. Process in such action may be served in any judicial district of which the defendant is an inhabitant or wherever the defendant may be found.

(d) Dates of application to actions

The provisions of this section shall become effective with respect to causes of action accruing on or after the date of enactment of the Futures Trading Act of 1982 [January 11, 1983]: Provided, That the enactment of the Futures Trading Act of 1982 shall not affect any right of any parties which may exist with respect to causes of action accruing prior to such date.

* * *

The By-Laws and Rules of the New York Clearing Corporation, as in effect when this case was filed in July 2000, provide in relevant part:

**Rule 401.** ***Acceptance for Clearance***

(a) The Corporation, by accepting a Contract offered to it for clearance by or on behalf of a Clearing Member, shall assume, in the place of each Clearing Member that is a party to such Contract, all liabilities and obligations imposed thereby to the Clearing Member that is the other party thereto, to the extent provided in Rule 401(b), and shall succeed to and become vested with all rights and benefits accruing therefrom. Such assumption by the Corporation shall terminate all liabilities and obligations of the Clearing Member whose Contract is so accepted to the other Clearing Member which was a party to such Contract.

(b) THE LIABILITIES AND OBLIGATIONS OF THE CORPORATION ARISING PURSUANT TO RULE 401(a) SHALL BE SUBJECT TO THE FOLLOWING LIMITATIONS:

(i) SUCH LIABILITIES AND OBLIGATIONS SHALL EXTEND ONLY TO CLEARING MEMBERS. WITHOUT LIMITING THE GENERALITY OF THE FOREGOING, THE CORPORATION SHALL NOT HAVE ANY LIABILITY OR OBLIGATION ARISING OUT OF OR WITH RESPECT TO ANY CONTRACT TO ANY CUSTOMER OF A CLEARING MEMBER OR ANY EXCHANGE MEMBER WHICH ACTED AS A BROKER FOR A CUSTOMER OR A CLEARING MEMBER;

(ii) IF ANY SUCH LIABILITY OR OBLIGATION ARISES OUT OF A FAILURE BY A CLEARING MEMBER TO MAKE OR ACCEPT DELIVERY OF A COMMODITY UNDER A CONTRACT WHEN

AND AS REQUIRED UNDER THE RULES OR ANY APPLICABLE EXCHANGE RULES:

(A) EXCEPT AS PROVIDED IN RULE 603, THE CORPORATION'S SOLE LIABILITY OR OBLIGATION SHALL BE TO PAY ANY DAMAGES AND PENALTIES PROVIDED FOR UNDER APPLICABLE EXCHANGE RULES FOR SUCH FAILURE, AND THE CORPORATION SHALL HAVE NO OBLIGATION TO MAKE OR ACCEPT DELIVERY OF ANY COMMODITY IN FULFILLMENT OF SUCH CONTRACT;

(B) IF SUCH FAILURE OCCURS AFTER THE DELIVERY NOTICE UNDER SUCH CONTRACT FOR THE PURCHASE OR SALE OF SUCH COMMODITY WAS ISSUED BY OR ASSIGNED TO SUCH CLEARING MEMBER, THE LIABILITY OF THE CORPORATION SHALL BE LIMITED, IN THE AGGREGATE, TO THE AMOUNT OF ORIGINAL MARGIN ON DEPOSIT WITH THE CORPORATION FROM SUCH CLEARING MEMBER FOR SUCH CONTRACT; AND

(C) ANY CLAIM AGAINST THE CORPORATION IN RESPECT OF SUCH FAILURE MUST BE MADE IN WRITING AND DELIVERED TO THE CORPORATION WITHIN ONE BUSINESS DAY AFTER SUCH FAILURE TAKES PLACE, OR SUCH CLAIM SHALL BE WAIVED AS AGAINST THE CORPORATION.

(iii) All such liabilities and obligations shall terminate after delivery of and payment for a commodity are made pursuant to these Rules and any applicable Exchange rules.

**Rule 402.** ***Trade Data Submission***

(a) The Corporation shall accept for clearance any Contract which has been matched by the Listing Exchange and has been submitted for clearance by or for such Exchange on behalf of the Clearing Members that are the parties thereto. The Corporation shall not accept for clearance any Contract or any transaction submitted to it by any person other than the Listing Exchange or its designated agent, except for transfers of Contracts and mechanical adjustments effected in accordance with any rules of the Listing Exchange, these Rules or the procedures of the Corporation permitting the submission thereof by persons other than the Listing Exchange.

(b) A Contract which has been matched by the Listing Exchange and has been submitted for clearance by or on behalf of any Clearing Member shall be deemed accepted by the Corporation for clearance when all processing of the day's trades have been completed and reports of cleared trades shall first have been made available to the Clearing Members. The Corporation shall have no liability or obligation to any Clearing Member or other person with respect to any Contract which has not been accepted by it for clearance.

(c) The Corporation shall be entitled to rely conclusively on the accuracy and authenticity of any information regarding any Contract submitted to the Corporation by the Listing Exchange on behalf of any Clearing Member, whether or not the Clearing Member in fact authorized the submission of such Contract for clearance.

(d) All Contracts accepted for clearance by the Corporation shall be subject in all respects to the By-Laws and these Rules.

(e) Any trade in a Contract which, on any day, is matched by the Listing Exchange but not accepted for clearance by the Clearing Member designated to clear such Contract, shall be automatically cleared to the account of the

Clearing Member which has guaranteed the Listing Exchange member who executed such trade on the day the trade was matched, provided that such guarantee has not been terminated in accordance with the rules of such Listing Exchange.

**Rule 403.** ***Daily Reporting of Open Contracts***

(a) Each Clearing Member shall report to the Corporation, by such time on each Business Day and in such manner as may be prescribed by the Corporation, such information as the Corporation may require with respect to Contracts which are open on such Clearing Member's books as of the close of business on the previous Business Day.

(b) If a Clearing Member discovers an error in any report made pursuant to this Rule 403, such Clearing Member shall as soon as practicable submit to the Corporation a correction and a written statement as to how the error occurred.

**Rule 404.** ***Reporting of Exchange Positions Carried by Other Firms***

(a) If a Clearing Member has customer or proprietary positions in any Contract carried for it by another Clearing Member or by a futures commission merchant which is not a Clearing Member, the Clearing Member first referred to shall:

(i) Give written notice to the Corporation of the name of such other Clearing Member or futures commission merchant not later than the close of business on the first day any such position is carried by such other Clearing Member or futures commission merchant; and

(ii) If any such position is being carried or maintained by a futures commission merchant which is not a Clearing Member, provide to the Corporation, on

each Business Day, by the time specified by the Corporation for the purpose, the information specified in Rule 404(b) concerning any such position.

(b) Each Clearing Member shall report to the Corporation, on each Business Day, by the time specified by the Corporation for the purpose, in such manner as may be prescribed by the Corporation, the number of long and short open positions in each Contract for each expiration month which such Clearing Member is carrying for any other Clearing Member as of the close of business on the preceding Business Day. Each such report shall separately specify positions carried for such other Clearing Member's proprietary account and customer account.

**Rule 405.** ***Transfers of Open Positions***

Any transfer of a Contract shall be subject to the following:

(a) if the transferor shall have been declared to be in default, transfers may only be effected at the current day's settlement price unless the Corporation in its discretion determines that, because of excess margin on deposit or for other sufficient reason, accepting the transfer at other prices permitted by Exchange rules would not jeopardize the Corporation; and

(b) if, in any case, the Corporation in its discretion determines that it would be contrary to the best interests of the Corporation to accept a transfer at a price other than the current day's settlement price, it may, notwithstanding any provision to the contrary in the Exchange rules, require such transfer to be effected at such settlement price.

* * *

The By-Laws and Rules of the New York Futures Exchange, as in effect when this case was filed in July 2000, provide in relevant part:

**Futures and Options Contracts Committee**

**Section 2.19** (a) The Board shall appoint a Futures and Options Contracts Committee, consisting of not less than 3 nor more than 15 members of the Exchange, as determined by the Board. The Committee shall have a Chairman and Vice Chairman, one of whom shall retire at the end of each month, and may act by multi-person panels appointed by the Chairman

(b) Each panel, so appointed, shall meet each day at the close of trading in the contracts over which it has jurisdiction and determine the tone of the market and the settlement prices of such contracts. Each such panel shall determine the settlement prices in the respective market in accordance with the procedures set forth in Rule 415.

(c) Each such Panel shall take cognizance of the questions arising in the regular course of business on the Exchange with respect to the market price properly obtaining at the time transactions within its respective jurisdiction are made and the recording of such transactions in the record of transactions; and it shall have authority to settle immediately disputes involving such questions.

(d) In performing its functions, no notice of meeting shall be given and the action of such number of members of the Committee who are present on the floor at the time, although a single member of the Committee, shall be deemed that of the Committee.

* * *

**Customer**

**Rule 14** The term "customer" means a person for whom a member or member organization carries an account (other than such member or member organization) or from whom any member, member organization or nominee solicits or accepts any order to effect any transaction involving a futures contract or an option contract.

* * *

**Offers to Buy or Sell**

**Rule 303** (a) No contracts shall be made or recorded for any month except those months authorized in the Rules governing said contracts.

(b) All offers to buy or sell contracts made on the floor of the Exchange shall be open to the member first accepting such offer, for the whole or any part of such offer; in case of simultaneous acceptances, that for the whole quantity shall take precedence over that for any part.

(c) All offers to buy or sell a contract shall be quoted in such terms as are set forth in the Rules governing said contracts.

(d) The time and price at which every contract is made shall be reported by the seller and/or buyer promptly, Transactions not so reported shall not be recorded in the record of transactions, except on the written consent of the Futures and Options Contracts Committee and provided that the posting or recording thereof shall not be later than ten minutes after the close of trading.

(e) Transactions made in any contract at a price above that at which such contract is offered or below that which is bid for such contract, until what is offered shall be taken or what is bid for shall be supplied, shall not be deemed made at the market price for such contract and shall not be reported or

recorded in the record of transactions. No transaction that is not made competitively by open outcry in the trading ring of the Exchange shall be permitted, reported, or recorded in the record of transactions except:

(1) transfers of open contracts of a clearing member or member firm necessitated by the death of the only member of such firm who had held membership in the Exchange;

(2) transfers of open contracts of a client, made at the request of such client, from one member to another member;

(3) transfers of open contracts of a client at the request of the original clearing member to another member;

(4) transfers of open contracts from one account to another within the same office of a clearing member, or between different offices of one clearing member, where no change in ownership is involved. The transferred contracts in the transferee account must be recorded at the original date and price;

(5) transfers of futures contracts in exchange for the underlying or comparable commodity, or exchange of futures in connection with spot transactions in the underlying commodity or a comparable instrument;

(6) transfers occurring after the close of trading on the last trading day of any delivery month in any contract (but not later than noon of the following business day) to rectify errors.

For purposes of this subsection (6), a clearing member carrying one or more open contracts for that delivery month for its own account or the account of any other person as the result of an error may, by consent, transfer any or all of such contracts to any other account carried by such clearing member or to any other clearing member; provided, however, that:

(i) for any delivery month, no clearing member may so transfer for its own account to the account of any other person more than 20 contracts in the aggregate; and

(ii) not later than noon of the business day following such last trading day, the clearing member effecting the transfer, in addition to other reports made in the manner and time required by this Rule shall deliver to the clearing house written notification of such transfer (in such form as the clearing house may prescribe), specifying the parties thereto and the prices at which such transfers were effected.

Such trades may be effected between or in the offices of the clearing member or clearing members but must be reported to the Exchange for recording, clearly showing the exception above justifying the trade and stating whether the transaction has resulted in a change of ownership, the quantity, if any, of the spot commodity involved, the kind and quantity of the contracts, the price, the name of the other clearing member, if any, and any other pertinent data. The clearing member must in its records clearly label all such trades. The names of the purchaser and seller shall be given when required.

Acceptances of offers or parts of offers to buy or sell shall be binding upon the acceptor at the price named by the member offering.

(f) Disputes arising in the regular course of business on the Exchange from bids, offers or acceptances, made at any other time than on a call, shall be settled by a member of the Futures and Options Contracts Committee submitting the question to the members present. The decision of the majority voting shall govern. When such a dispute arises on a call, the question shall be decided on the spot by the Caller.

(g) Disputes involving questions of the time and price at which contracts were made, or of the market price properly obtaining at the time such contracts were made, or of the recording of transactions in the record of transactions, shall be referred to the Futures and Options Contracts Committee which, after hearing both parties, shall render a decision that shall be final.

(h) If an error or dispute arises between members as to a claim of a purchase or a sale of a contract, the party claiming the sale or purchase shall, unless otherwise mutually agreed upon, liquidate the same as soon as possible and the loss resulting shall be the subject of arbitration. Any claim of a purchase or sale of a contract must be made promptly after discovery and no later than five minutes before that contract's next opening.

For purposes of subsections (h) and (i), if the transaction is claimed to have occurred

(i) during original hours, "next opening" shall mean the first opening of the contract which takes place between 8:00 A.M. and 11:00 A.M. in New York on the next trading day.

(ii) during extended hours, "next opening" shall mean the 7:00 P.M. opening on the next trading day in New York.

(i) If a member claims to have bought or sold, or has bought or sold, a contract and the member with whom the trade has been made, or is claimed to have been made, is absent or cannot be found, the trade shall be closed at the contract's next opening, and notice of such closing of the trade shall be filed with the Exchange, and the resulting loss, if any, shall, if the trade is disputed, be subject to arbitration, and if not disputed, shall be immediately paid.

* * *

**Straddle Transactions**

**Rule 313** (a) Members of this Exchange are permitted to execute futures or options contract orders to purchase one futures contract and sell another futures contract at a stated price difference ("futures straddle") or to effect one options transaction in conjunction with another options transaction as set forth in paragraph (b) below ("options spread"), to effect one options transaction in connection with a futures transac-

tion as set forth in paragraph (c) below ("futures/options spread"), or to effect a transaction on this Exchange simultaneously with a transaction on another exchange as set forth in paragraph (d) below ("Inter-Exchange transaction") in such configurations of such contracts as may be recognized by the Exchange. Such transactions must be for the account of one customer except in the case of a transfer of interest in an authentic commercial transaction. These orders are to be executed competitively by public open outcry in the ring with at least one side of the futures straddle or options spread at the market price prevailing at the time of the trade.

In the case of futures/options spreads, the futures side shall be priced at the futures price prevailing at the time of the trade. In inactive futures months or options series or classes in which there are no prevailing market prices because there have been no trades, bids or offers in either futures month or in the respective options series or class, the prices must bear a reasonable relationship to the respective prevailing market prices of active futures or options. It shall be the trading member's responsibility to insure that orders executed in this manner be properly recorded in writing permitting identification of these transactions and the parties thereto, and that straddles and spreads are posted and announced in such manner as the Exchange may direct.

(b) For purposes of this Rule, options spreads are options transactions in the same or comparable class, all sides of which are executed in conjunction with one another and that fit into one or more of the following definitions or multiples thereof:

(1) *Vertical and Horizontal Options Spreads:* Short one call (put) and long another call (put) with a different strike price and/or expiration month.

(2) *Options Straddles:* Short (long) puts and calls in a generally accepted spread ratio.

(3) *Options Butterflies*: Two vertical spreads which share one common strike price.

(4) *Option Boxes:* Long a call and short a put at one strike price and short a call and long a put at another strike price.

(5) *Option Ratio Spreads:* Long calls (puts) and short calls (puts) in a generally accepted spread ratio.

(6) *Options Synthetic Futures:* Long calls (puts) and short puts (calls in a generally accepted spread ratio.

(c) For purposes of this Rule, futures/options spreads are transactions all sides of which are executed in conjunction with one another consisting of options and a future concerning which:

(1) The execution takes place in a location designated by the Exchange.

(2) The sides of the resulting transactions generally offset one another.

Examples of futures/options spreads which would qualify are:

(A) Synthetic Straddles: Long (short) futures and short (long) calls or long (short) puts in a generally accepted spread ratio.

(B) Conversions and Reverse Conversions: Long (short) puts, short (long) calls, and long (short) futures,

(C) Such other configurations of futures/options spreads which the Exchange determines to be generally offsetting.

(d) For purposes of this subsection, the term Inter-Exchange transaction means a straddle or spread transaction in which one leg is executed on this Exchange and the remaining leg is simultaneously executed on any other exchange.

Inter-Exchange transactions are permitted provided that:

(1) the trading member has current trading privileges on both exchanges; and

(2) the Inter-Exchange transaction is of a class and quantity authorized by the Exchange.

(e) Nothing in this Rule shall be construed to prevent the execution of futures straddles by individual purchases and sale or of futures/options spreads or options spreads by individual transactions.

* * *

**Definitions**

**Rule 601** The following terms shall, for the purpose of these Arbitration Rules, have the following meanings, unless otherwise indicated:

(a) Controversy. Any claim, grievance or dispute which arises out of any transaction on or subject to the Rules of the Exchange executed by or effected through a member of the Exchange or employee thereof, which does not require for adjudication the presence of essential witnesses or third parties over whom the Exchange does not have jurisdiction and who are not otherwise available. The term "controversy" does not include a claim, grievance or dispute arising from cash market transactions which are not a part of, or directly connected with, any transaction for the purchase or sale of any contract effected on the Exchange.

(b) Statutory Controversy. Any controversy between a customer and a member or employee of a member.

(c) Inter-Exchange Transaction Controversy and Procedure

(1) Inter-Exchange Transaction shall mean a straddle or spread transaction (or order) recognized by the Exchange in which one leg of the straddle or spread transaction is executed (or is intended to be executed) on the Exchange and the

other leg is simultaneously executed (or is intended to be simultaneously executed) on another futures contract market ("Other Exchange") with respect to a futures or options contract in which that Other Exchange has been designated by the Commodity Futures Trading Commission.

(2) Controversy. Any controversy involving an Inter-Exchange Transaction.

(3) Procedure. The procedure to be followed in Inter-Exchange Transaction Controversies shall be as set forth by written agreement between this Exchange and such Other Exchange(s). Those agreements together with these Rules shall govern the arbitration of claims arising out of Inter-Exchange Transactions as defined herein. A listing of those agreements currently in effect, as well as the agreements themselves, are available upon request to the Secretary's office. Parties who are involved in an Inter-Exchange Transaction Controversy should consult those agreements as well as these Rules.

(4) Nothing set forth herein or in any agreement with Other Exchange(s) shall limit a customer's right (as claimant or respondent in arbitration) to a choice of forum under CFTC Reg. 180.1(b)

(d) Non-Statutory Member Controversy. Any controversy between a member and another member. For the purpose of this paragraph a controversy shall include any claim, grievance or dispute relating to a transaction on the Exchange or to a transaction to be made on the Exchange or to the relations or obligations to each other of the parties to a transaction which is governed by the By-Laws or Rules of the Exchange.

(e) Customer. A person other than a member of the Exchange who has a controversy with a member of the Exchange or an employee thereof.

(f) Member. A member of the Exchange or a partnership, corporation or association on which the benefits of member-

ship have been conferred pursuant to the Rules of the Exchange, including former members to the extent set forth in the By-Laws.

(g) Claimant. A person who asserts a claim under these Arbitration Rules.

(h) Respondent. A person against whom a claim is asserted under these Arbitration Rules.

(i) Panel. A three member panel appointed to hear and determine a controversy under these Arbitration Rules. Except where a Mixed Panel is appointed, a Panel shall consist of a subcommittee of three members of the Arbitration Committee.

1. the 3 person Panel provided for in Rule 601(i) or (j);

2. in the case of a small claims matter assigned to a sole arbitrator, the arbitrator;

3. before a Panel has been appointed by the Chairman of the Arbitration Committee, the Chairman of the Arbitration Committee.

(j) Mixed Panel. A Panel consisting of one member of the Arbitration Committee and two persons who are not members of any contract market or associated with any member of a contract market or employees thereof, and who are not otherwise associated with a contract market (a "non member"). If the matter is a statutory controversy and a small claim as provided in (m)(l) below, the Panel shall consist solely of one person who is a non-member.

(k) Counterclaim. A claim which falls within the definition of a controversy asserted by the respondent against the claimant.

(l) Service. The delivery of pleadings and other documents to and from the Exchange and the parties. For purposes of these Arbitration Rules, service can be accomplished by hand delivery, mail, including express mail (by private or public courier), or by facsimile transmission (fax).

With respect to any such method employed, it is the responsibility of the sender to have and maintain proof of service. With respect to any time period required within these Rules, service shall be deemed to be made on the day that a pleading or document has been hand delivered, faxed or deposited with an express mail service; in the event of service by regular mail, service shall be deemed to have been made three days after deposit with the postal service.

(m) Small Claims

1. Any claim together with any counterclaim, if any, which aggregates less than $5,000 shall be decided by one arbitrator without a hearing, subject to 2 below.

2. If the Chairman of the Arbitration Committee or sole arbitrator, when appointed, determines that a hearing before a three person panel would be appropriate, then the small claim shall be so heard. The Chairman (or sole arbitrator) may make such decision at the request of any party or on his own motion.

3. If a small claims procedure occurs, the sole arbitrator shall be empowered at any time before he closes the proceedings to request documents and clarification including, but not limited to, written and/or oral testimony from the parties and others within the jurisdiction of the Exchange, as well as publicly available records from the Exchange staff, all on written notice to each of the parties.

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In The

# Supreme Court of the United States

KLEIN & CO. FUTURES, INC.,

*Petitioner,*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., ET AL.,

*Respondents.*

**On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit**

## REPLY BRIEF OF PETITIONER


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## REPLY BRIEF FOR PETITIONER

Respondents are charged by federal law with enforcement of their rules to keep the commodity futures market honest. They failed to do so in bad faith by, *inter alia*, allowing the chairman of respondent New York Futures Exchange, in his role as chairman of the settlement committee for P-Tech futures, to manipulate the settlement price of those futures.

Petitioner, by contrast, followed the rules. Petitioner, as a futures commission merchant, was required by the rules to collect a minimum level of margin from its clients trading in P-Tech futures according to that settlement price set by respondents. Because respondents provided inaccurate information to petitioner about the settlement price of P-Tech futures, petitioner did not demand enough margin from its customers and could not ultimately meet the demand from the clearing organization when the manipulation was revealed and an accurate, and much different, settlement price was set, which put petitioner out of business.

If respondents had enforced their rules, they would not have allowed their settlement committee chairman to manipulate the settlement price and would not have provided petitioner with the inaccurate settlement price. In turn, petitioner would have required adequate margin from its customer and would not have come to be in a position where its customer, First West (which was owned by the individual who was manipulating the settlement price) provided inadequate margin that did not allow petitioner to cover the losses with the clearing organization.

Respondents' failure to enforce their rules was a violation of the Commodity Exchange Act (CEA). Congress spoke directly to such conduct in the CEA, and authorized an express cause of action by any person "who engaged in any transaction on or subject to the rules" of the exchange against entities such as respondents that fail to enforce bylaws or rules. 7 U.S.C. § 25(b)(1) (1994). The court below erroneously held that petitioner lacked statutory standing to bring a claim under Section 25(b)(1), because it read Section

25(b)(1) to allow suits only by a plaintiff who is a buyer or a seller of futures.

The Commodity Futures Trading Commission (CFTC) does not read the statute in that manner. Neither does the leading industry trade association, whose regular membership consists of 35 of the Nation's largest futures brokerage firms, and whose associate membership consists of approximately 150 firms involved in virtually all other segments of the industry (including contract markets and clearing organizations). And the text and structure of the CEA make clear that such a restrictive reading of Section 25(b)(1) is untenable. Congress used language of breadth—"any transaction on or subject to the rules" of a contract market or board of trade (including, pursuant to CFTC regulations, a clearing organization). Congress circumscribed the cause of action elsewhere by requiring a showing of bad faith and limiting relief to actual damages. Congress thereby struck the balance it thought appropriate to promote effective self-regulation and private enforcement of futures markets rules.

Petitioner does not contend, as respondents repeatedly claim (Resp. Br. 18, 28, 44, 45), that *all* activity that is related in any manner whatsoever to the futures market is actionable. But clearing members such as petitioner have always been understood by Congress to be "essential participants" in every transaction entered into on a contract market and on a clearing organization, and "futures trading has a direct financial impact" on them. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 359-360 (1982). There is no reason that Congress would have excluded clearing members from the cause of action for actual damages that were caused by respondents' bad faith violations of law, particularly without saying so.[1]

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[1] Under respondents' view, Congress not only intended to exclude petitioner from Section 25(b)(1), it also intended petitioner to have no recourse in any forum for actual damages caused by respondents' unlawful conduct. Respondents argued below that the CEA preempts petitioner's state law claims regarding respondents' conduct. Resp. C.A.

(Continued on following page)

## I. RESPONDENTS' READING OF THE COMMODITY EXCHANGE ACT IS CONTRARY TO ITS TEXT AND PURPOSE AND THE EXPERT VIEWS OF THE FEDERAL AGENCY CHARGED WITH ITS ADMINISTRATION

Respondents have abandoned the Second Circuit's rationale that the cause of action under Section 25(b)(1) incorporates the requirements of the cause of action under Section 25(a). *See* Resp. Br. 20-21 n.11. They are correct to do so because that rationale is contradicted by the statutory text, as our opening brief demonstrates. Nonetheless, respondents attempt to narrow Section 25(b)(1) down to a cause of action that would apply only in the most limited circumstances, making it effectively the same as the limits expressly provided in Section 25(a). But respondents' effort to reach the same result through different means is similarly without support in the text, structure or history of the statute.

### A. The Phrase "Any Transaction" Does Not Reflect A Congressional Intent To Limit The Section 25(b)(1) Cause Of Action To "Buyers And Sellers" Or "Traders," As Respondents Urge

1. Wherever Congress intended to limit a provision of the CEA to "buyers and sellers" or to "traders," it did so through express use of those terms. Congress used none of these terms in Section 25(b)(1) and respondents are wrong to attempt (Resp. Br. 22-25) to so confine that provision.

For example, in Section 25(a)(1)(D), Congress limited a cause of action explicitly to persons who "purchased or sold"

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Br. 41-48. The court of appeals did not reach this issue, instead affirming the district court's discretionary dismissal of the state law claims after it had dismissed the federal claim. Pet. App. 13a-15a. Petitioner filed a state court action in March 2007 raising one state law defamation claim against respondent NYBOT. In May 2007, NYBOT moved to dismiss that claim arguing, *inter alia*, that it was preempted by the CEA. The state trial court has not yet ruled on that motion.

contracts. If Section 25(b)(1) were intended to impose the same limitation as Section 25(a)(1)(D), Congress would have used the term "purchased or sold" contracts in Section 25(b)(1) rather than the broader term "engaged in any transaction."

Respondents contend that the express textual limitation of Section 25(a)(1)(D) nonetheless applies to Section 25(b)(1) because, in their view, Congress used "purchased or sold" as a type of shorthand because it would somehow have been "awkward" to use in Section 25(a)(1)(D) the phrase "transaction on or subject to the rules of a contract market" as it used in Section 25(b)(1). Resp. Br. 29. That contention gives no weight to the settled cannon of construction that different words in the same statutory section must be given different meanings. *See Sosa v. Alvarez-Machain*, 542 U.S. 692, 711 n.9 (2004) ("when the legislature uses certain language in one part of the statute and different language in another, the court assumes different meanings were intended"). It also suggests that Congress valued non-awkwardness over consistency, but it is clear from the text of the CEA that Congress tolerated many awkward phrasings to use terms consistently.

Respondents also point to a number of places in the statute where Congress used the word "trade" near the word "subject to the rules," Resp. Br. 24-25, and they suggest that the term "transaction" when used near the word "subject to the rules" should be given the same meaning. But Congress's use of the term "trade" or "contract" (which respondents' claim is synonymous with trade) in several provisions of the CEA, *see*, *e.g.*, 7 U.S.C. §§ 6i, 7a(a)(7), 7a(a)(12)(A), 12b (1994), only highlights that it chose to use a different term in Section 25(b)(1), *i.e.*, "transaction," that has a much broader scope. Contrary to respondents' claim (Resp. Br. 29), examination of the entire statute is the appropriate process in which to determine the meaning of a term used throughout the statute, not just certain pre-selected provisions.

The provision of the statute that defines the CFTC's exclusive regulatory jurisdiction over certain matters

provides a particularly useful example of the fact that Congress did not view these terms to be interchangeable. Section 2(i) granted the CFTC exclusive jurisdiction over certain "transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market." 7 U.S.C. § 2(i) (1994). In order to limit the scope of the broad term "transactions" in this provision, Congress added requirements that the transaction involve futures sales contracts that are "traded or executed" on the contract market, which demonstrates that the use of the term "transactions" in Section 25(b)(1) without the modifying phrase is not limited to trades. Respondents cite (Resp. Br. 25) *FTC v. Ken Roberts Co.*, 276 F.3d 583 (D.C. Cir. 2001), *cert. denied*, 537 U.S. 820 (2002), but that case does not support their artificially narrow reading of the term. The D.C. Circuit held that the term "transactions" as used in Section 2(i) (codified as amended in 2000 at 7 U.S.C. § 2(a)(1)(A)) is "most naturally read as encompassing * * * a set of arrangements directly related to the actual sale of commodities futures," including "categories of financial arrangements through which the trading of commodities occurs *or is facilitated*." *Id.* at 590 (emphasis added). Thus, that ruling confirms that the term "transactions" as used in Section 25(b)(1) without any such modification has an even broader scope, including clearing functions.

If Congress had intended to limit the scope of Section 25(b)(1) so that it applied not to all transactions that are on or subject to the rules of a contract market, but only to some subset of such transactions, Congress would have done so as it did in other portions of the CEA. *See* 7 U.S.C. § 7a(a)(15)(D) (1994) (describing the consequences when "a contract market takes final disciplinary action against a member for a violation that involves the execution of a *customer transaction*") (emphasis added). Instead, Congress used the phrase "any" transaction and "any" is a modifier that conveys "an expansive meaning." *United States v. Gonzales*, 520 U.S. 1, 5 (1997). Congress was clear, and respondents' efforts to create uncertainty are unavailing.

2. Respondents broadly declare that "every court" to address the issue has ruled that Section 25(b)(1) is available only to traders of futures contracts. Resp. Br. 2, 28. Respondents' citations include only one appellate case—*American Agricultural Movement, Inc. v. Board of Trade of Chicago*, 977 F.2d 1147 (7th Cir. 1992)—and the plaintiffs in that case did not claim to have standing under any subsection of Section 25(b) but, instead, were seeking to recover under an implied private right of action. The plaintiffs were farmers not involved in the commodity futures trading market in any way, but who wanted to sell in the cash market.

Respondents' other citations are to four trial court rulings. Any language in those cases about who can bring suit under Section 25(b)(1) must be read in the context of the distinct circumstances of each case, none of which involved claims brought by a clearing member such as petitioner. One case addressed only a claim under Section 25(a). *See Unity House, Inc. v. First Commercial Fin. Group*, 1997 WL 701345, No. 96C-1716 (N.D. Ill. Nov. 5, 1997), *aff'd*, 175 F.3d 1022 (7th Cir. 1999). Two cases were resolved based on a failure to sufficiently plead bad faith (an issue respondents pressed below but that has never been addressed by any court). *See DGM Invs., Inc. v. New York Futures Exch., Inc.*, 2002 WL 31356362, No. 01 Civ. 11602 (S.D.N.Y. Oct. 17, 2002); *Vitanza v. Board of Trade of the City of New York, Inc.*, 2002 WL 424699, No. 00 CV 7393 (S.D.N.Y. Mar. 18, 2002). The fourth case was brought by a person who had traded on foreign futures markets and was seeking to hold domestic markets responsible for the effects an alleged conspiracy had on the foreign markets. *See de Atucha v. Commodity Exch., Inc.*, 608 F. Supp. 510 (S.D.N.Y. 1985). In none of those cases did the district court have before it the views of the CFTC, which is before this Court urging reversal. Thus, none of those cases compel narrowing the Section 25(b)(1) cause of action to exclude clearing members.

### B. Respondents' Effort To Narrow Section 25(b)(1) Is Contrary To The CFTC's Longstanding View And Congressional Intent That Clearing Transactions Be Subject To The CEA

Respondents appear to acknowledge that petitioner *did* engage in transactions on or subject to the rules of a clearing organization because they state that the clearing process "creates two new agreements" to which an FCM like petitioner is indisputably a party. Resp. Br. 7. To attempt to avoid the reach of Section 25(b)(1), however, they argue that its reference to "any transaction on or subject to the rules of such contract market" does not include the rules of a clearing organization. Resp. Br. 25-27. But at the time that Congress enacted Section 25(b)(1) in 1982, it was well established in a 1976 CFTC regulation that "rules of a contract market" included rules of a clearing organization. *See* Pet. Br. 15 n.7. Although respondents are correct that the CFTC regulation, of course, addressed a different statutory provision because Section 25 had not yet been enacted, the CFTC was interpreting the same statutory phrase "rules of a contract market."

Respondents offer no support for the view that Congress would, in enacting Section 25(b)(1), intend the phrase "rules of such contract market" to mean something other than the meaning already attributed to that statutory phrase through notice-and-comment regulations. *See CFTC v. Schor*, 478 U.S. 833, 845-846 (1986). The United States does not view the CFTC's regulatory interpretation as limited to a single provision (*see* U.S. *Amicus* Br. 26), and the agency's understanding of its own regulation is entitled to the strongest form of deference. *See Auer v. Robbins*, 519 U.S. 452, 461 (1997).[2]

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[2] Respondents claim (Resp. Br. 21 n.12) that the CFTC's views on the scope of the cause of action are entitled to no deference, citing *Adams Fruit Co., Inc. v. Barrett*, 494 U.S. 638 (1990). But *Adams Fruit*, in holding that a federal agency's interpretation of a statute did not compel a court to hold that a federal remedy was preempted by state law, did not suggest that a federal agency's views would be disregarded in fitting

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Indeed, the CFTC confirmed in *Interpretive Letter No. 82-5*, Comm. Fut. L. Rep. ¶ 21,964 (Div. of Trading & Mkts., June 15, 1982), cited by respondents (Resp. Br. 27 n.16), that the rules of a contract market and its clearing organization cannot be treated as separate and that, in fact, a contract market has an "obligation * * * to enforce the approved rules of its clearing organization" against "participants in the system" even if "the clearing organization is separately incorporated." Thus, whether the petitioner's actions are viewed as a number of distinct but related transactions on the contract market and clearing organization or as subsidiary components of a single transaction, *see* U.S. *Amicus* Br. 24-25 n.13, it is clear that petitioner engaged in transactions subject to the rules of a contract market.

Contrary to respondents' assertion (Resp. Br. 26-27 n.16), this settled understanding that the reference to the "rules of such contract market" in Section 25(b)(1) includes rules of the contract market's clearing organization does not make redundant the reference to clearing organizations elsewhere in Section 25(b)(1) or generally. A clearing organization is subsumed in a contract market only for purposes of its *rules*, not for all purposes. *See also* CFTC, *Contract Market Rules & Authority Delegation*, 41 Fed. Reg. 40,091, 40,093 n.8 (Sept. 17, 1976) (CFTC rejecting similar argument in promulgating regulation).

Respondents appear to concede that the statute currently in effect (after the 2000 amendments) would permit petitioner to bring the instant action against respondents because, after the amendments, Section 25(b)(1) explicitly cites the rules of a "registered entity," which is a term that plainly encompasses both contract markets and clearing organizations. Resp. Br. 26 & n.15; *see also* U.S. *Amicus* Br. 25 n.14 (reading respondents' brief in opposition

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together parts of a highly technical statute. This Court has often given *Chevron* deference to agency interpretation of the elements of a federal cause of action. *See, e.g., Chevron U.S.A. Inc. v. Echazabal*, 536 U.S. 73 (2002) (giving *Chevron* deference to EEOC regulation defining meaning of affirmative defense in private cause of action).

not to dispute that proposition). But there is absolutely no support whatsoever for the proposition that Congress intended its 2000 amendments to substantively alter the scope of the cause of action; it intended the amendments to make only a clarification. Pet. Br. 15 n.7; U.S. *Amicus* Br. 3 n.1.

### C. The Remedy Under Section 25(b)(1) For Recovery Of "Actual Losses" Does Not Restrict The Cause Of Action To Buyers And Sellers

Respondents contend (Resp. Br. 27) that the remedy authorized under Section 25(b)(1) limits who can bring the cause of action. They argue that the use of the term "actual losses" in Section 25(b)(1) must mean "trading losses."

First, it is far from clear that the term "actual losses" was intended to have a narrower meaning than "actual damages," which is also used in Section 25(b)(1). In other provisions of the CEA, the term "losses" appears to be treated as broader than "damages."[3]

Second, even if "actual losses" are different from "actual damages," there is no justification for reading the statute to limit "losses" to *trading* losses. And, as we discuss on pages

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[3] Sections 7a and 21 require contract markets and registered futures associations to have arbitration procedures for the resolution of customers' claims against their members. *See* 7 U.S.C. §§ 7a(a)(11), 21(b)(10) (1994). In certain cases, the procedures must allow for the "payment of *actual damages* proximately caused by such violation." *Id.* §§ 7a(a)(11)(i), 21(b)(10)(i) (emphasis added). Where such a violation is willful and intentional, those provisions further require procedures that allow for punitive damages "in addition to *losses* proximately caused by the violation, in an amount equal to no more than two times the amount of such *losses*." *Id.* §§ 7a(a)(11)(ii), 21(b)(10)(ii) (emphasis added). It would appear that the term "losses" in those provisions was intended to be equal or broader, but certainly not narrower, than the term "damages," because a person who engaged in a willful and intentional violation would be required to pay "losses proximately caused" (plus capped punitives), while a less culpable person would be required to pay "actual damages proximately caused." There is no reason to think Congress intended to provide a lesser measure of compensatory relief for victims of willful and intentional violations than other victims.

18-19, *infra*, it is clear that petitioner sustained actual losses in this case.

### D. The Legislative History Provides No Evidence Of A Congressional Intent To Exclude Clearing Transactions And Section 25(b)(1)'s Authorization Of Suit By Clearing FCMs Does Not Lead To Absurd Results

1. Respondents contend (Resp. Br. 38-40) that the legislative history of Section 25(b)(1) demonstrates that Congress intended to create a cause of action for investors. But nothing in respondents' extensive canvassing of the legislative history reveals any intent by Congress to create an action *only* for investors.

This Court has made clear that the legislative history of a statute need not discuss a particular scenario in order for the statute to apply in such a situation. Congress may have a particular paradigmatic case in mind when it approaches certain legislation, but it then often enacts a broader remedial principle. *See Oncale v. Sundowner Offshore Servs., Inc.*, 523 U.S. 75, 79 (1998). "[T]he fact that a statute can be applied in situations not expressly anticipated by Congress does not demonstrate ambiguity. It demonstrates breadth." *Pennsylvania Dep't of Corrections v. Yeskey*, 524 U.S. 206, 212 (1998) (internal quotation marks omitted).

Moreover, the only relevant case law prior to the enactment of Section 25 *permitted* a clearing FCM to sue an exchange under the CEA's implied private right of action, as respondents reluctantly concede. *See* Resp. Br. 37 (discussing *Seligson v. New York Produce Exch.*, 378 F. Supp. 1076 (S.D.N.Y 1974)). Respondents point to no legislative history stating that Congress intended to adopt a different approach (despite the *Seligson* case being cited by this Court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982)), nor to any case law prohibiting such an action prior to the enactment of Section 25.

2. Respondents argue (Resp. Br. 43-44) that the interpretation of petitioner and of the United States would somehow affect other unrelated provisions of the CEA, but

respondents do not take into account the context or exact terminology of those other provisions.

Contrary to respondents' claim (Resp. Br. 43), the interpretation of petitioner and of the United States would not extinguish an investor's cause of action under Section 25(b)(1). *See* U.S. *Amicus* Br. 29. Indeed, it is only respondents' creation of heightened proximate causation requirement, which is found nowhere in the text of the statute, that would yield such a result. We demonstrate below, pages 15-17, that there is no such requirement.

Respondents then attempt to have it both ways and claim (Resp. Br. 44) that any investor cause of action that does survive would produce impermissible, duplicative recoveries. But the fact that a contract market or clearing organization's bad faith misconduct may have directly injured several persons does not mean that providing redress to each person for that person's "actual losses" is in any way duplicative.

Respondents' view of the structure of Section 25(b)(1) (Resp. Br. 44-45) to require the narrowing of the cause of action to lessen the threat of liability for potential defendants ignores the various express limits in the statutory text that Congress placed on the cause of action that make it rather unattractive in comparison to other express federal causes of action or state common law torts. A plaintiff must show that the defendant acted in bad faith in its enforcement or failure to enforce the rules in order to establish liability. *See* 7 U.S.C. § 25(b)(4) (1994). Further, no punitive or treble damages are permitted under Section 25(b)(1), just "actual damages." Also, the CEA does not authorize an award of attorneys' fees for a prevailing party. And CEA claims may be heard only in federal court, thus providing an extra layer of protection to ensure that litigation does not stray beyond the intent of Congress. *Id.* § 25(c).

## II. PETITIONER IS ENTITLED TO SUE EVEN UNDER RESPONDENTS' CRAMPED LIMITATION OF SECTION 25(b)(1) TO BUYERS AND SELLERS

Even if respondents were correct to limit Section 25(b)(1) to buyers and sellers of futures on a contract market (and not

a clearinghouse), petitioner would satisfy their standing requirement because an FCM such as petitioner, which is a clearing member, is necessarily a buyer or seller of every futures contract.

As respondents acknowledge, a clearing member "assume[s]" the contract to buy or sell commodity futures under the rules of the contract market, here NYFE. Resp. Br. 6. Petitioner thus "engaged" in such transactions within the meaning of Section 25(b)(1). Although respondents describe this as a "quite transitory" or "extremely brief" status, Resp. Br. 10, 41, it is, even under respondents' view, petitioner's status for some period of time and places it within the class of those who are eligible to sue under Section 25(b)(1).

In fact, the NYFE rules confirm that a futures contract is always made "on behalf of a clearing member who shall be the buyer or seller of said contract" and who subsequently "assume[s] said contract" in writing. Pet. Br. 14a (NYFE Rule 306(i)(2) (2000)). Respondents seek to deflect the impact of this rule by first contending (Resp. Br. 41) that an exchange rule cannot affect the scope of the federal statute. But the rule simply reflects the reality of the futures market.

Respondents are wrong (Resp. Br. 6 n.4, 41 n.22) to contend that the markets have adopted varied approaches, suggesting that clearing members may be able to sue the other contract markets, but not respondent NYFE. The United States explains that NYFE Rule 306(i)(2) "is in keeping with general custom in the industry" that "[t]he initial buy-sell agreement that is formed on the floor of the exchange (*i.e.*, before the clearinghouse's assumption of obligations as part of the clearing process) is a trade between FCMs." U.S. *Amicus* Br. 21. The federal government's understanding of the industry should be respected because the CFTC exercises extensive oversight of the contract markets and their rules. (Indeed, prior to 2000, the CFTC was required to approve the rules of a contract market and its clearinghouse. *See* 7 U.S.C. § 7a(a)(12) (1994)). The government's view is confirmed by the consistent judicial discussion of the role of clearing members in different contract markets. *See* Pet. Br. 38 n.15 (citing, *inter alia*, *Leist*

*v. Simplot*, 638 F.2d 283 (2d Cir. 1980) (discussing New York Mercantile Exchange), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), and *Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179 (7th Cir. 1984) (discussing Chicago Mercantile Exchange and relying on *Leist*)).

Respondents also attempt to deconstruct the text of NYFE Rule 306(i)(2) (Resp. Br. 41-42) by suggesting that the rule's provision that the contract is made "on behalf of a clearing member," refers to an agency relationship between a clearing member and its customer. But the rule describes the events from the position of a broker who executes a trade, and the rule makes clear that the broker makes the contract "on behalf of a clearing member." Pet. Br. 14a. That rule has nothing to do with the relationship between a clearing member and its customer.

## III. PETITIONER SUSTAINED ACTUAL LOSSES THAT RESULTED FROM THE TRANSACTIONS IN WHICH IT ENGAGED AND THAT WERE CAUSED BY RESPONDENTS' FAILURES TO ENFORCE THEIR RULES, BUT THOSE ISSUES ARE NOT PROPERLY BEFORE THE COURT

In the final pages of their brief, respondents give a nod to the weakness of their standing argument by raising a new claim that the complaint does not adequately allege causation or actual losses. Those issues are not properly before this Court. Moreover, respondents are wrong on the law and on the facts. The complaint plainly alleges that petitioner sustained actual losses that were caused by respondents' failure to enforce their rules regarding the transactions in which petitioner engaged.

### A. Respondents Did Not Preserve A Proximate Cause Argument

Respondents assert that "[t]he proximate cause issue" has been "raised repeatedly at every stage of the litigation." Resp. Br. 48 n.24. That is incorrect. Rather, respondents

consistently have argued that Section 25(b)(1) "creates a bright line test for standing—if the plaintiff was not a trader, then the plaintiff does not have standing." Resp. C.A. Br. 23. That standing argument was erroneously accepted by the district court and the court of appeals and respondent defended it in its brief in opposition. *See*. Br. in Opp. 6 ("the court of appeals correctly held that Petitioner lacked standing to bring CEA claims against the NYBOT respondents under Section [25](b) because Petitioner was not itself a trader").[4]

Respondents now raise a question regarding the showing that must be made to establish that respondents are liable because their bad faith misconduct caused petitioner's actual damages. Causation goes to the merits of whether petitioner has stated a claim for relief; it does not go to the separate standing question of whether petitioner falls within the class of people intended to be able to sue under the statutory cause of action, assuming they can show respondents' violation of law caused them damages. *See Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 92 (1998)

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[4] Proximate cause was neither pressed before the court of appeals nor passed on by that court, where respondents urged affirmance of the district court's holding that petitioner "lacked standing" under Section 25(b)(1) because it was not a trader, Resp. C.A. Br. 17-34, and urged three alternative grounds for affirmance (unavailability of declaratory relief, failure to adequately allege bad faith, and failure to allege fraud with particularity), *id.* at 35-40. Respondents did not raise causation or cite the cases that they now claim are relevant. The court of appeals accepted respondents' standing argument. Pet. App. 11a (holding that "the clear text of the statute" provides that "Section [25](b)'s remedies are expressly available only to a private litigant who 'engaged in any transaction on or subject to the rules' of contract markets or other registered entities" and that petitioner did not engage in such transactions because it "was not an owner of P-Tech contracts traded by First West"). The language quoted by respondents (Resp. Br. 47) about profits and losses involved an alternative argument advanced by petitioner that petitioner had standing by analogy to the "forced" seller doctrine under the Rule 10b-5 implied private right of action. The court of appeals held that argument irrelevant to the express statutory cause of action under the CEA, and alternatively held that petitioner would not have qualified as a forced seller or purchaser because it had "no interest in any of the resulting profits or investment losses." Pet. App. 12a.

(distinguishing "statutory standing," which addresses "whether [a statute] authorizes this plaintiff to sue" from "the scope of the [statutory] right of action," which "goes to the merits").

The structure of Section 25(b)(1) makes this clear. It identifies the person who can sue—"a person who engaged in any transaction on or subject to the rules of the contract market or licensed board of trade." It identifies the *actus reus* required to establish a violation—failure by a contract market, clearing organization, or licensed board of trade to enforce, or illegal enforcement of, any rule. And then it identifies the relief—"actual damages" "to the extent of such person's actual losses that resulted from such transaction and were caused by" the defendant's failure to enforce the rules. (The *mens rea* requirement—bad faith—is supplied in Section 25(b)(4)).

In any event, even if respondents had raised their strict proximate causation argument below, the failure of the court of appeals to address the issue (particularly free from its erroneous restriction of standing to buyers and sellers) and respondents' limited discussion of the issue in this Court, weigh heavily against this Court addressing the proximate cause issue. *See Anza v. Ideal Steel Supply Corp.*, 126 S. Ct. 1991, 1999 (2006) ("We decline to consider [whether respondent alleged proximate cause for its] § 1962(a) claim without the benefit of the Court of Appeals' analysis, particularly given that the parties have devoted nearly all their attention in this Court to the [proximate cause for its] § 1962(c) claim.").

### B. Respondents' "Strict Proximate Cause" Argument For Section 25(b)(1), Derived From RICO And Antitrust Law, Is Insupportable

1. The Racketeer Influenced and Corrupt Organizations Act (RICO) and antitrust cases cited by respondents (Resp. Br. 48-50) to attempt to create a heightened causation requirement for Section 25(b)(1) are inapposite.

First, RICO and the antitrust laws allow the recovery of treble damages and attorneys' fees in every case in which a

plaintiff prevails. *See* 18 U.S.C. § 1964(c); 15 U.S.C. § 15(a). The "potency of the remedy," *Blue Shield of Virginia v. McCready*, 457 U.S. 465, 477 (1982), has led the Court to develop and apply specialized proximate causation requirements in such circumstances. *See Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 111 & n.6 (1986) (holding that "the difference in the remedy each section" of the antitrust laws authorizes "affect[s] the nature of the injury cognizable under each section"); *see also Scheidler v. National Org. for Women, Inc.*, 537 U.S. 393, 411-412 (2003) (Ginsburg, J. concurring) (noting that the Court is "rightly reluctant * * * to extend RICO's domain further" given the "hefty civil liability on those engaged in conduct within the Act's compass"). The remedy available under Section 25(b)(1) is much less potent, limited to actual damages, and thus there is no need for the causal connection to be as strict.

Furthermore, Section 25(b)(1) differs significantly from RICO and the antitrust laws in terms of its subject matter. RICO and the antitrust laws are prohibitory in character and apply to the entire economy. Section 25(b)(1), however, is intended to enforce an affirmative government mandate that highly-regulated entities in the commodity futures market do something (*e.g.*, properly enforce their rules) to protect private parties from wrongdoing by third parties, which also protects the integrity of the commodity futures markets in the nation's economy. Thus, Congress would not have intended that the strict showing of causation in the RICO or antitrust context be required to determine whether a violation of the CEA by a contract market or clearing organization's failure to enforce its rules resulted in a plaintiff's losses.

Nor is there any reason to think Congress intended decisions based on RICO and antitrust laws to be incorporated into Section 25(b)(1). Respondents' assertion (Resp. Br. 48) that Section 25(b)(1) uses "language similar" to those statutes is wrong. Those statutes permit treble damages and attorneys' fees to a person "injured in his business or property by reason of" a violation of particular laws. 18 U.S.C. § 1964(c); 15 U.S.C. § 15(a). Neither statute

uses the language of causation that Congress specified in Section 25(b)(1).[5]

2. Respondents' new strict proximate cause argument also once again seeks to incorporate into Section 25(b)(1) statutory limitations that appear only in *other* sections of the CEA. Congress expressly imposed a "proximately cause[d]" standard for private parties to recover actual damages under four provisions of the CEA. *See* 7 U.S.C. §§ 25(a)(3)(A), 18(a)(1)(A), 7a(a)(11)(i), 21(b)(10)(i) (1994).

Imposition of that causation standard in those provisions is explained by the fact that each *also* authorizes recovery of punitive damages up to two times the amount of actual damages upon a showing of a "willful and intentional" violation. Congress thus appears to have determined that the opportunity for an injured party to recover damages exceeding actual damages required a proximate cause requirement. But Section 25(b)(1) does not allow for punitive damages or any type of multiplier. Congress did not include the "proximately caused" language in Section 25(b)(1) and that difference must be given meaning. Pet. Br. 29-30.

### C. Petitioner's Complaint Alleges Actual Losses

Finally, respondents' new argument regarding actual losses cannot sustain the judgment below.

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[5] *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), supports a finding of causation here, contrary to respondents' claim. Resp. Br. 48-49. *Holmes* was a private treble damages action decided under RICO and the Court held, on summary judgment, that a conspiracy to manipulate securities prices that bankrupted "broker dealers" did not proximately cause the damages of their *customers* who did not purchase the manipulated securities. The Court so held because it viewed the "broker-dealers" who had been bankrupted due to the manipulation as the "directly injured" parties who could (and had) sued the conspirators. *Holmes*, 503 U.S. at 273. In a parallel manner, because it is petitioner who was put out of business due to respondents' failure to enforce their rules to prevent manipulation, it is petitioner who is a "directly injured" party who can sue respondents.

For the reasons set forth above, the actual losses requirement (like causation) goes to the scope of relief recoverable, not to statutory standing, and thus is not appropriately raised at this time. Respondents are wrong, in any event, that petitioner did not sustain actual losses under Section 25(b)(1).

First, they assert (Resp. Br. 50) that petitioner's allegations regarding the $4.5 million margin deficit (in response to which respondents seized funds that petitioner had held for its customers) cannot establish petitioner's actual losses because respondent NYBOT paid that money back to petitioner's customers. But their only support for this assertion are the allegations of a complaint that they filed against petitioner (which was consolidated in the district court with the instant case). Resp. Br. 50 (citing Resp. Br. 15, citing Pet. App. 28a-29a & n.13, which repeats the allegations made by respondents in their complaint against petitioner). An exhibit filed by respondents in that case makes clear, however, that petitioner paid $1.34 million of its *own* money to its customers to replace in part money that respondents had seized from the funds petitioner had held on behalf of its customers.[6] Thus, although petitioner's complaint is not so specific on this point as it might be, it is clear that petitioner sought relief due to payments it made in response to respondents' seizure of its customers' funds. *See* J.A. 26 (Comp. ¶ 110) (respondents seized $8 million in funds petitioner was holding for its customers); 48-49 (Comp.

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[6] That exhibit is a settlement agreement between petitioner, respondents, the New York Mercantile Exchange (NYMEX), and 15 of petitioner's customers that explains that petitioner "voluntarily deposited with NYMEX approximately $1.34 million in funds which NYMEX is now holding as custodian for Klein * * * on behalf of Klein's customers," and that petitioner "authorize[d] NYMEX to distribute the funds held in the Custodian Account to the Individual Plaintiffs" as part of the settlement. *Board of Trade of the City of New York v. Klein & Co. Futures, Inc.*, No. 01-cv-04071, Dkt. No. 14, Exh. D, at 2, 4 (S.D.N.Y Aug. 30, 2002). This money paid by petitioner was in addition to the $4.5 million that respondents paid petitioner's customers and which respondents are currently seeking to recover from petitioner. Resp. Br. 50.

¶¶ 207-210) (respondents' seizure of petitioner's customer's money injured petitioner).

Second, the complaint alleges that petitioner was required by NYCC rules to deposit into a NYCC "guaranty fund" no less than $300,000 and as much as $3.5 million. J.A. 20-21, 72-73 (Comp. ¶¶ 74-76; NYCC Rule 5.4(a)(iii) (2000)). That money has not been returned to petitioner and that constitutes an actual loss.

Third, the complaint alleges that petitioner was forced to close its business because, after respondents seized its money, it no longer had sufficient capital to retain its membership privileges on the contract market and clearing organization. J.A. 39 (Comp. ¶ 156). That plainly resulted in actual losses by petitioner. Harkening back to its proximate cause argument, respondents contend (Resp. Br. 49-50) that such losses are too indirect. But because a plaintiff must show a defendant's bad faith to recover damages under Section 25(b)(1), the scope of actual losses that are compensable should not be arbitrarily limited and instead should be viewed commensurate with the state of mind required to prevail. *Cf. Restatement (Second) of Torts* § 435B cmt. a ("responsibility for harmful consequences should be carried further in the case of one who does an intentionally wrongful act than in the case of one who is merely negligent or is not at fault").

Thus, petitioner's allegations have plainly given respondents notice of its "actual losses" under "the liberal pleading standards" set forth by Federal Rule of Civil Procedure 8(a), *Erickson v. Pardus*, 127 S. Ct. 2197, 2200 (2007), as necessary to resist a motion to dismiss for failure to state a claim under Rule 12(b)(6). As the Court explained: "[s]pecific facts are not necessary; the statement need only 'give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.'" *Ibid.* (quoting *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955, 1964 (2007)).

Further, petitioner's actual losses were the result of respondents' multiple failures to enforce their rules. The complaint makes clear allegations that, *inter alia*, petitioner relied on the manipulated settlement prices issued by

respondents in setting margin levels, and that respondents waived regulatory requirements for the purpose of inducing petitioner to continue its contractual commitments to the clearing organization. J.A. 18, 20-21, 30, 38-39 (Comp. ¶¶ 61, 74-79, 121, 153-156). *See also, e.g.*, *Blue Shield*, 457 U.S. at 479-480 (permitting patient to recover under antitrust laws when the injury to her "was clearly foreseeable" even though the target of the antitrust violation by a health insurance company was the doctors and the patient would not have been injured if her employer had not purchased a particular insurance plan for her). Of course, loss and causation are both fact-based case-specific inquiries, another reason that they should not be resolved by this Court in the first instance.[7]

## CONCLUSION

For the reasons set forth above and in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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[7] If the complaint were found to not state a claim upon which relief could be granted due to the causation or loss issues, petitioner should be entitled to amend the complaint to address any purported omissions or uncertainties. *See* Fed. R. Civ. P. 15(a) (plaintiff may file amended complaint as of right so long as, as in this case, no answer has been filed; and otherwise with leave of court, which "shall be freely given when justice so requires"). Although petitioner did not previously seek leave to file such an amended complaint, respondents' arguments in the district court gave petitioner no notice that the allegations of the complaint regarding causation and loss were relevant to the statutory standing issue on which respondents sought to dismiss the complaint. Indeed, because the district court did not address those grounds, seeking leave after the district court dismissed the case to file an amended complaint to supplement or clarify those allegations would have been pointless. *See Van Buskirk v. The New York Times Co.*, 325 F.3d 87 (2d Cir. 2003) (district court need not permit amendment of complaint after dismissal under Rule 12(b)(6) if even a liberal reading of the complaint gives it no indication that the opportunity to amend might allow the statement of a valid claim).

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No. 06-1265

# In the Supreme Court of the United States

KLEIN & CO. FUTURES, INC., PETITIONER

*v.*

BOARD OF TRADE OF THE CITY OF NEW YORK, ET AL.

*ON WRIT OF CERTIORARI*
*TO THE UNITED STATES COURT OF APPEALS*
*FOR THE SECOND CIRCUIT*

## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

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## QUESTION PRESENTED

Whether petitioner, a futures commission merchant and a clearing member of the New York Futures Exchange, is a proper plaintiff under 7 U.S.C. 25(b)(1) (1994), which established a private right of action for "a person who engaged in any transaction on or subject to the rules of [a] contract market or licensed board of trade."

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## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

### INTEREST OF THE UNITED STATES

The Commodity Futures Trading Commission (CFTC or Commission) is a federal agency created by Congress in 1974 to administer the Commodity Exchange Act (CEA), 7 U.S.C. 1 *et seq.* The question presented in the instant case concerns the CEA's express private right of action, see 7 U.S.C. 25, which was added to the statute in 1983. Private suits can provide a useful supplement to the CFTC's resolution of customer reparation complaints pursuant to 7 U.S.C. 18, thereby enhancing the Commission's ability to use its resources in an efficient manner. In addition, the proper application of Section 25 in this case turns on more general principles concerning the respective rights and obligations of various participants in the commodity futures trading industry. The United States therefore has a substantial interest in the proper inter-

pretation of Section 25 and its application to the circumstances of this case.

## STATEMENT

1. Futures contracts in a variety of commodities are subject to extensive federal regulation under the CEA. Until 1982, the CEA did not expressly provide for private lawsuits. In *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353 (1982), however, this Court construed the CEA to establish an implied right of action. See *id.* at 374-388. Early the following year, the CEA was amended to add a new Section 22, codified at 7 U.S.C. 25, which expressly authorized private suits under specified circumstances. See Futures Trading Act of 1982, Pub. L. No. 97-444, § 235, 96 Stat. 2322.

The instant case involves the application of 7 U.S.C. 25(b)(1), which authorizes private suits against contract markets, clearing organizations, and boards of trade. In May 2000, at the time of the events that are alleged to give rise to liability in this case, Section 25(b)(1) provided as follows:

> (b) Liabilities of organizations and individuals; bad faith requirement; exclusive remedy
>
> (1)(A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by section 7a(8) and section 7a(9) of this title, (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or (C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this chapter or any Commission rule, regulation, or order, shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to

> the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

7 U.S.C. 25(b)(1) (1994) (footnotes omitted).[1]

2. a. In May 2000, petitioner was a futures commission merchant (FCM). Pet. App. 2a, 4a-5a. The CEA defines the term "futures commission merchant" to mean an individual or other entity that "is engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market," 7 U.S.C. 1a(20)(A), and that accepts money or property to secure such orders, 7 U.S.C. 1a(20)(B). An FCM must be registered with the CFTC. 7 U.S.C. 6d(a)(1).

In May 2000, respondents New York Futures Exchange (NYFE) and New York Cotton Exchange (NYCE) were both boards of trade designated as contract markets by the CFTC

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[1] Because the question presented in the instant case concerns the range of plaintiffs that may pursue a private right of action under the CEA, that question is appropriately resolved under the law in effect at the time of the events that are alleged to give rise to liability. Cf. *Hughes Aircraft Co.* v. *United States ex rel. Schumer*, 520 U.S. 939, 946-951 (1997). As amended in December 2000, see Commodity Futures Modernization Act of 2000 (CFMA), Pub. L. No. 106-554, App. E, § 123(a)(25)(B)(i)(I) and (III), 114 Stat. 2763A-410 and 2763A-411 (7 U.S.C. 25(b)(1)), Section 25(b)(1) currently provides that a "registered entity" may be liable to "a person who engaged in any transaction on or subject to the rules of such registered entity." The term "registered entity" is defined under current law to include, *inter alia*, a "board of trade designated as a contract market," 7 U.S.C. 1a(29)(A), and a "derivatives clearing organization," 7 U.S.C. 1a(29)(C). The latter term is in turn defined to mean "a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization." 7 U.S.C. 1a(9)(A). The December 2000 law described the changes to 7 U.S.C. 25(b)(1) as "TECHNICAL AND CONFORMING AMENDMENTS." CFMA § 123, 114 Stat. 2763A-405.

pursuant to 7 U.S.C. 7 (1994) and were both among the subsidiaries of respondent Board of Trade of the City of New York (NYBOT).[2] See Pet. App. 18a & n.3. Respondent New York Clearing Corporation (NYCC), a subsidiary of NYCE (and thus an indirect subsidiary of NYBOT), acted as clearing organization for the NYBOT futures exchanges, including NYFE and NYCE.[3] See *New York Futures Exch., Inc.*, CFTC Docket No. 01-13, 2001 WL 777042, at *2 (July 11, 2001) (*N.Y. Futures Exch.*). In its role as an FCM, petitioner served as an intermediary for its customers who traded on futures exchanges within the NYBOT. Pet. App. 3a. In some instances, FCMs may also trade "on their own accounts"—*i.e.*, they may enter into futures transactions as investments for themselves rather than on behalf of customers. See 17 C.F.R. 1.3(k) and (y).[4]

Petitioner was a "clearing member" of the NYCC, see Pet. App. 2a, and was therefore authorized to "clear with the

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[2] In August 2003, all contracts listed for trading on the NYFE were transferred to the NYCE. In June 2004, the NYCE and another subsidiary were merged with and into the NYBOT, with the NYBOT being the sole surviving exchange. The NYBOT and the IntercontinentalExchange, Inc. (ICE) entered into a merger agreement on September 14, 2006. The merger was completed on January 12, 2007, at which time the NYBOT became a wholly-owned subsidiary of ICE.

[3] After the merger of the NYCE into the NYBOT, the NYCC became a wholly-owned subsidiary of NYBOT. Effective June 1, 2007, the NYCC's name was changed to ICE Clear US, Inc.

[4] An FCM must treat each customer's funds deposited with the FCM as the property of that customer, see 7 U.S.C. 6d(a)(2), and it therefore may not use one customer's money to satisfy obligations incurred by another customer, see 17 C.F.R. 1.22. An FCM is not required, however, to establish a separate account for each customer, but may instead create a single omnibus customer account. See 17 C.F.R. 1.20(c); *Lincolnwood Commodities, Inc. of Col.*, CFTC Docket No. 78-48, 1984 WL 48104, at *13 (Jan. 31, 1984). If an FCM also trades on its own account, it must establish a separate account for those "proprietary" trades. See *id.* at *10-*11; 17 C.F.R. 1.3(k) and (y).

[NYCC] Contracts effected on or subject to the rules of an Exchange," J.A. 94 (NYCC By-Law 1.1); see ICE Clear US, Inc. (ICE Clear US) By-Law 1.1.[5] In May 2000, the trading of futures contracts was typically done by "open outcry" on the floor of the exchange, with FCMs or their representatives on both sides of the transaction agreeing (generally through hand signals) on price and quantity. See S. Rep. No. 384, 97th Cong., 2d Sess. 187 (1982) (1982 Senate Report); *Leist* v. *Simplot*, 638 F.2d 283, 287 (2d Cir. 1980), aff'd *sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353 (1982). Both sides would then report the trade to the clearinghouse, which matched the trades and resolved any discrepancies between the parties' reports. 1982 Senate Report 188. "As trades are matched and confirmed at the end of each trading session, the clearinghouse takes the opposite side of every transaction. It becomes the seller of all 'buys' and the buyer of all 'sells.'" *Ibid.*[6] The clearinghouse thus

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[5] Portions of the NYCC Rules and By-Laws that were in force in May 2000 are reproduced at J.A. 85-201. The current ICE Clear US Rules and By-Laws are the successors to those rules and by-laws. See notes 2-3, *supra*. In the experience of the CFTC, the NYCC and ICE Clear US Rules and By-Laws are typical of the rules and by-laws of clearinghouses generally insofar as they define the legal relationships between the parties to a trade in the futures markets—*i.e.*, the customers on each side of the trade, the clearing FCMs on each side of the trade, and the clearinghouse itself.

In May 2000, trading on the floor of the NYFE was governed by the NYFE Rules. The former NYFE Rules are reproduced in the New York Futures Exchange Guide (CCH). The current NYBOT Rules now govern trading on NYBOT, which is the successor to all the exchanges formerly under the NYBOT umbrella. The current rules and by-laws of both the NYBOT and ICE Clear US are available at *About NYBOT: Rulebooks* (visited July 17, 2007) <http://www.nybot.com/aboutNYBOT/rulebooks/indexRulebooks.htm>.

[6] Electronic trading currently accounts for at least 60% of all trading volume on United States futures exchanges. See *Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations*, 71 Fed. Reg. 38,740 n.8 (2006). In the electronic environment, traders place orders on a terminal, which is directly

"assumes the legal responsibility for the opposite side of every transaction made on the contract market." *Ibid.*

Even when clearing FCMs enter into futures contracts on behalf of their customers rather than on their own accounts, "[c]learinghouses look to the funds and credit of clearing FCMs for satisfaction of trading obligations rather than to the actual floor broker, floor trader, or other customer." Division of Trading & Markets, CFTC, *Report on Lessons Learned from the Failure of Klein & Co. Futures, Inc.* 2 (July 2001) <http://www.cftc.gov/files/tm/tmklein_report071101.pdf> (*Lessons Learned*); see *id.* at 16 ("[A]n FCM is responsible for losses suffered in the customer accounts it carries."). That is a long-established feature of the commodity futures trading industry. As the CFTC explained more than 20 years ago, "clearing organizations * * * generally have as their direct customers FCMs, not the ultimate 'customers' who entered into the futures contracts and options positions for which the [FCM's] margin funds were posted." 50 Fed. Reg. 36,050 (1985); see *Leist*, 638 F.2d at 287 ("The clearinghouse treats FCM's as principals in trading transactions."); *CFTC Interpretative Statement No. 85-3*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,703, at 30,987 (Off. Gen. Counsel Aug. 12, 1985).

At the conclusion of the clearing process, the clearing FCM on each side of the transaction has contractual rights and obligations vis-a-vis the clearinghouse, as well as a separate contractual relationship with that FCM's customer. See ICE Clear US Rule 401(a) (explaining that the clearinghouse, "by accepting a Contract offered to it for clearance by or on

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connected to the electronic market, rather than executing trades via open outcry on an exchange floor. However, the legal relationships between the clearinghouse and its clearing members on the one hand, and between clearing members and their customers on the other, remain the same in the electronic trading environment as in the "open outcry" environment described in the text.

behalf of a Clearing Member, shall assume, in the place of each Clearing Member that is a party to such Contract, all liabilities and obligations imposed thereby to the Clearing Member that is the other party thereto"); NYFE Rule 306(i)(2), N.Y. Futures Exch. Guide (CCH) ¶ 2523, at 2517 (Apr. 2002) (NYFE Guide) (all trades must be submitted for clearing) (compare NYBOT Rule 4.03(f)); J.A. 173-174 (NYCC Rule 504(a)) (describing payment obligations between the clearinghouse and its clearing members resulting from each day's trading gains and losses). The customers themselves, however, are not in privity of contract either with the clearinghouse or with each other. See ICE Clear US Rule 401(b)(i) (explaining that the liabilities and obligations of the clearinghouse "shall extend only to clearing members," and that the clearinghouse "shall not have any liability or obligation arising out of or with respect to any contract to any customer of a clearing member"). Rather, the customer's contractual relationship is with the clearing FCM that is ultimately responsible to the clearinghouse for the customer's trades. See *Lessons Learned* 2.

b. Margin accounts serve as security for the performance by both FCMs and customers of payment obligations (to the clearinghouse and the FCM, respectively) that arise from losing positions. An FCM must deposit with each clearinghouse of which it is a member a sum sufficient to meet its margin requirement, generally computed in accordance with the Standard Portfolio Analysis of Risk (SPAN) system. See J.A. 170 (NYCC Rule 502(a)); *Lessons Learned* 3 n.6. The amount of the required margin is based on analysis of all customer and other positions "carried" by the FCM (*i.e.*, positions for which the FCM bears financial responsibility) with the clearinghouse, and it is intended to cover, at a confidence level of 95-99%, the maximum loss that the FCM could reasonably be expected to suffer on those positions during a sin-

gle trading day. See *id.* at 3 & nn.6-7, 4. At least once each day, the FCM pays to or collects from the clearinghouse the net losses or gains for that day on all positions that the FCM carries. See J.A. 173-174 (NYCC Rule 504(a)).

The FCM engages in a similar process with respect to each of its customers. "An FCM that carries customer positions is required to collect margin from the customer in an amount that is determined by the exchange on which the position is executed." *Lessons Learned* 3; see *Leist*, 638 F.2d at 287; NYFE Rule 703, NYFE Guide ¶ 5005, at 5012 (Sept. 2002) (compare NYBOT Rule 5.03). The exchange establishes minimum requirements for customer margins, leaving the FCM free to insist on higher levels of margin if it chooses. *Lessons Learned* 3. "An FCM will frequently require higher margin levels from customers that it believes expose the FCM to higher levels of financial risk." *Ibid.* At least once a day, the FCM credits the accounts of its customers whose positions gained value and debits the accounts of customers whose positions lost value. See *id.* at 4. If a customer's account falls below the minimum required balance, the FCM will demand additional margin and may liquidate the account if the additional margin is not forthcoming. See NYFE Rule 703(c), NYFE Guide ¶ 5005, at 5012 (Sept. 2002) (compare NYBOT Rule 5.03(e)-(g)).

c. "Settlement prices" of futures contracts are used to assess the value of FCM and customer positions at particular points in time, and thus to determine whether additional margin payments are required. See *Lessons Learned* 8; *Norman Eisler*, CFTC Docket No. 01-14, 2004 WL 77924, at *2 (Jan. 20, 2004) (*Eisler*). The process of establishing settlement prices varies among exchanges and clearinghouses but, in the "open outcry" environment, it typically involves the use of a "settlement committee" or "pit committee." See *Lessons Learned* 8. At the time of the events at issue in this case,

tion, and First West's corrected margin deficit was determined to be approximately $4.5 million. J.A. 21, 22, 24-25 (Compl. ¶¶ 80, 84, 96-101); Pet. App. 4a-5a, 19a-20a.

Petitioner was directly liable to the NYCC for the losses incurred as a result of the trades that it had carried at the behest of Eisler and First West (see p. 6, *supra*), but petitioner had insufficient funds to discharge that obligation. See J.A. 25 (Compl. ¶¶ 102-105); Pet. App. 5a, 21a. When petitioner defaulted on that payment obligation, NYBOT and NYCC suspended petitioner's memberships. J.A. 26 (Compl. ¶ 107); Pet. App. 5a. To obtain satisfaction of petitioner's financial obligations resulting from the P-Tech futures and options trades cleared by petitioner, NYBOT and NYCC liquidated the assets in petitioner's segregated customer account, which included funds belonging to *all* of petitioner's customers. *Id.* at 21a.[9] Petitioner's business subsequently collapsed. *Id.* at 5a.

4. In July 2000, petitioner filed suit against various entities and individuals, including respondents NYBOT, NYCC, NYFE, and NYCE as well as Eisler and First West. See J.A. 9-57 (complaint).[10] Petitioner invoked, *inter alia*, the express

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[9] NYBOT subsequently entered into a settlement under which it purchased the claims of petitioner's customers other than First West at full value, thereby protecting those customers from any financial loss as a result of petitioner's default. See J.A. 80-81; Pet. App. 28a & n.13. Respondents NYBOT and NYCC, as subrogees to petitioner's customers, have pursued those claims against petitioner. *Id.* at 28a-29a. The district court denied respondents' motion for judgment on the pleadings, see *id.* at 27a-33a, and the claims remain pending.

[10] On July 11, 2001, while petitioner's suit was pending in the district court, the CFTC issued an administrative order finding that, "[f]rom at least August 1999 to May 12, 2000, the NYFE * * * failed to enforce its rule for determining settlement prices for P-Tech Options." *N.Y. Futures Exch.*, 2001 WL 777042, at *1. The CFTC explained that the Settlement Committee of the NYFE had "failed to use any of the methods set forth in NYFE Rule 315(a-c)" to establish

private right of action contained in 7 U.S.C. 25(a)-(b) (1994). At the time of the events giving rise to this suit, 7 U.S.C. 25(a)(1)(A)-(D) (1994) identified four categories of plaintiffs who could file suit for damages against a defendant "other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association." 7 U.S.C. 25(a)(1) (1994). The potential plaintiffs identified by Section 25(a) included persons who had "purchased" or "sold" an option or futures contract. 7 U.S.C. 25(a)(1)(C) and (D) (1994).

Section 25(b)(1) of Title 7 provided that, under certain circumstances involving improper failures to enforce or comply with applicable bylaws, rules, or regulations, a contract market, clearing organization, or licensed board of trade could be held "liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade." 7 U.S.C. 25(b)(1) (1994). A person bringing such an action must establish that the contract market, clearing organization, or licensed board of trade acted in bad faith. 7 U.S.C. 25(b)(4) (1994).

The gravamen of petitioner's claims against respondents was that those defendants, acting in bad faith, had failed adequately to monitor and supervise the process by which settlement prices for P-tech futures and options were calculated. See J.A. 29, 37-38, 41 (Compl. ¶¶ 119-120, 147-150, 164, 166).

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settlement prices for P-Tech futures and options, and that the committee had not complied with NYFE Rule 315(d)'s requirement that any alternative methodology be supported by a written explanation. *Id.* at *2. The CFTC further found that the NYFE's failure to enforce Rule 315 violated statutory and regulatory provisions requiring each contract market to enforce its own rules. See *ibid.* (citing 7 U.S.C. 7a(a)(8) (1994); 17 C.F.R. 1.51(a), 1.53 (2000)). The CFTC imposed a civil penalty of $75,000. *N.Y. Futures Exch.*, 2001 WL 777042, at *1. The NYFE consented to entry of the order but neither admitted nor denied the CFTC's findings. See *id.* at *1; see also note 8, *supra* (describing CFTC administrative enforcement action against Eisler and First West).

NYFE Rule 315 specified the procedures to be used in calculating settlement prices for positions on that exchange. See NYFE Rule 315, NYFE Guide ¶ 2541, at 2522 (Apr. 2002) (compare NYBOT Rule 4.28).

3. In early May 2000, First West Trading, Inc. (First West) incurred significant losses in Pacific Stock Exchange Technology Index futures and options contracts (P-Tech futures and options) traded on the NYFE. Pet. App. 3a, 17a-18a. Norman Eisler, the principal of First West and the Chairman of the NYFE, directed the underlying trades. See *ibid.* Petitioner's complaint in this case alleged that Eisler's trading decisions were made "without input, counsel, advice or any type of recommendation whatsoever from [petitioner]." J.A. 17 (Compl. ¶ 56).

Because Eisler was a registered floor broker (see 7 U.S.C. 1a(16) and 6e; 17 C.F.R. 3.11) and a member of the NYFE, *Eisler*, 2004 WL 77924, at *1, he was entitled to execute trades on behalf of First West on the floor of the exchange. Under the NYFE's rules, however, Eisler could exercise floor trading privileges only if he was guaranteed by a "clearing member" that agreed to accept for clearance any trades effected by Eisler. See NYFE Rules 116(a)(i), 118(a)(i), NYFE Guide ¶¶ 2221, 2231, at 2107, 2109 (Sept. 2000) (compare NYBOT Rules 2.16(a)(i) and 2.18(a)(i)). Petitioner served as Eisler's clearing FCM, thereby assuming direct liability to the clearinghouse for Eisler's trades and playing an essential role as a participant in consummating those trades. See Pet. App. 3a, 17a-18a; NYFE Rule 306(i)(2), NYFE Guide ¶ 2523, at 2517 (Apr. 2002).[7]

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[7] Under NYFE Rule 306(i)(2), NYFE Guide ¶ 2523, at 2517 (Apr. 2002), every contract made on the Exchange "by a trading member shall be made on behalf of a clearing member who shall be the buyer or seller of said contract on the terms set forth therein." Rule 306(i)(2) further required that "[t]he clearing member shall assume such contract in writing within one hour after receipt of

Eisler was also a member of the NYFE's Settlement Committee for P-Tech futures and options. Pet. App. 3a. The Settlement Committee calculated P-Tech contract prices for the purpose of setting margin requirements for customer accounts. *Ibid.* According to petitioner's allegations in the instant suit, Eisler used his authority on the Settlement Committee to set the P-Tech settlement prices at levels that caused First West's positions initially to appear more favorable than they actually were. See J.A. 18 (Compl. ¶ 60); Pet. App. 4a, 19a.[*] Petitioner further alleged that "[t]he incorrect information regarding the settlement price was disseminated by NYBOT and was used by [petitioner] to calculate margin requirements applicable to First West's account," and that "[t]his miscalculation of the P-Tech Settlement Price * * * caused the margin calculations for First West's account to be incorrect." J.A. 18 (Compl. ¶¶ 61, 62); see Pet. App. 4a, 19a.

On May 12, 2000, Eisler notified petitioner that First West was unable to meet a call for additional margin, which at that time was calculated to be approximately $700,000. Shortly thereafter, Eisler was removed from the Settlement Committee. On May 15, 2000, the Settlement Committee recalculated P-Tech futures and options prices without Eisler's participa-

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a report from the trading member identifying the terms thereof." Thus, as a result of its agreement to serve as Eisler's clearing member, petitioner was treated as "the buyer or seller" of each of Eisler's contracts and was obligated to assume those contracts.

[*] On July 11, 2001, the CFTC filed an administrative enforcement action against Eisler and First West, charging them with manipulation in violation of 7 U.S.C. 9 and 13b (1994), 17 C.F.R. 33.9(d), and with making false reports in violation of 7 U.S.C. 13(a)(4) (1994). See *Eisler*, 2004 WL 77924, at *1. On January 20, 2004, the Commission entered an order finding that Eisler and First West had violated the CEA and Commission regulations, and requiring, *inter alia*, that Eisler and First West pay a civil penalty of up to $4,923,000. See *id.* at *8. Eisler and First West consented to entry of the order but neither admitted nor denied the CFTC's findings. See *id.* at *1.

Petitioner further alleged that "[t]he incorrect settlement prices caused the margin computation to skew, thereby creating a perception of lower margin risk to FCMs and potential financial disaster to FCMs, who could not anticipate or prepare for the drastic change in P-Tech Settlement Price of the P-Tech Futures and options when the error was corrected." J.A. 30 (Compl. ¶ 121); cf. *Lessons Learned* 15 ("If the settlement price does not accurately reflect the market price at the time of settlement, the potential loss may be greater than one day's price movement.").

The district court dismissed petitioner's federal claims against all defendants, holding that petitioner was not a proper plaintiff under the terms of 7 U.S.C. 25. Pet. App. 23a-26a. The court found that petitioner "lack[ed] standing under" Section 25 because petitioner did "not allege that it was either a purchaser or a seller of P-Tech Futures and Options" and did "not claim that it traded for its own account." *Id.* at 24a. In light of its dismissal of petitioner's federal claims, the district court declined to exercise supplemental jurisdiction over the state-law claims and accordingly dismissed the suit in its entirety. *Id.* at 26a-27a.

5. The court of appeals affirmed. Pet. App. 1a-15a. The court held that petitioner did "not fall within any of the required subdivisions of" 7 U.S.C. 25(a)(1)(A)-(D) because petitioner "functioned merely as a broker or agent" rather than as a buyer or seller of P-Tech contracts. Pet. App. 9a. The court of appeals further held that petitioner was not a proper plaintiff under 7 U.S.C. 25(b). The court explained that the remedies provided by Section 25(b) "are expressly available only to a private litigant who 'engaged in any transaction on or subject to the rules' of contract markets or other registered entities." Pet. App. 11a (quoting 7 U.S.C. 25(b)(1)). The court also observed that petitioner "was not an owner of P-Tech contracts traded by First West" and "did not fall within

any of the categories enumerated in" Section 25(a)(1)(A)-(D). *Ibid.*

Petitioner contended that it was a proper plaintiff under the CEA "because it faced essentially the same risks as a purchaser or seller of commodities contracts." Pet. App. 12a. In rejecting that argument, the court of appeals held that, because petitioner "was not a trader of P-Tech contracts" and "did not own the P-Tech contracts at issue," the pecuniary injury that petitioner suffered "was a credit loss, not a trading loss." *Ibid.* The court concluded that petitioner "lack[ed] standing because it was not 'engaged in any transaction on or subject to the rules' of a contract market and did not suffer any 'actual losses that resulted from such transaction.'" *Id.* at 13a (quoting 7 U.S.C. 25(b)(1)).[11]

## SUMMARY OF ARGUMENT

A. For purposes of determining whether petitioner is a proper plaintiff under 7 U.S.C. 25(b)(1) (1994), it is irrelevant whether petitioner falls within any of the categories set forth in Section 25(a)(1)(A)-(D). At the time of the transactions at issue here, Section 25(a)(1)(A)-(D) applied by its terms to suits against persons *other than* contract markets, boards of trade, clearing organizations, and futures associations. The respondents in this Court are two contract markets, a board of trade, and a clearing organization. Petitioner's claims against respondents therefore are governed not by Section 25(a)(1)(A)-(D) but by Section 25(b)(1), which rendered such entities liable to suit by persons who had "engaged in any transaction on or subject to the rules of [a] contract market or licensed board of trade." 7 U.S.C. 25(b)(1) (1994). Section 25(b)(1) does not cross-reference Section 25(a)(1)(A)-(D) or

[11] The court of appeals also held that the district court had not abused its discretion in declining to exercise supplemental jurisdiction over petitioner's state-law claims. Pet. App. 13a-15a.

otherwise suggest that a person who "engaged in" a covered transaction must also satisfy Section 25(a)(1)(A)-(D)'s requirements.

B. In both a practical and a legal sense, petitioner "engaged in" (*i.e.*, carried on or participated in) transactions subject to the rules of a contract market or licensed board of trade. Under the governing rules, Eisler's trades were made on behalf of petitioner, who (prior to clearance) was deemed by those rules to be the buyer or seller obligated to the other party to the trade. Eisler was allowed to execute trades on the floor of the NYFE only because petitioner had agreed to clear those trades. The transactions were clearly subject to the NYFE Rules, and petitioner's agreement to clear those trades and to accept full responsibility to the NYCC for any resulting losses was essential to the consummation of the relevant trades. Under the rules of the NYCC and the NYFE, moreover, the ultimate legal effect of the clearing process was to create a contract between petitioner and the clearinghouse. Although First West had separate contractual rights and obligations vis-a-vis petitioner, First West was not in privity of contract with the NYCC, the clearing FCM on the other side of the transaction, or the other FCM's customer. And under the contracts with the NYCC that resulted from petitioner's clearance of Eisler's trades, petitioner was directly liable to the clearinghouse for any decline in the value of First West's positions.

Thus, petitioner (1) served as principal obligor for the trades that Eisler executed on the floor of the Exchange, (2) played an indispensable role in the consummation of the overall trading transactions, (3) entered into a direct contractual relationship with the clearinghouse as part of those transactions, and (4) was liable to the clearinghouse for the decline in value of First West's positions. Each factor is a reflection of the rules of the NYFE or the NYCC that govern these trades.

And those factors taken together indicate that petitioner "engaged in" the transactions at issue in this case.

C. As noted, the "transaction[s]" in which petitioner "engaged"—*i.e.*, the trades that petitioner cleared on First West's behalf—were "on or subject to the rules of [a] contract market or licensed board of trade." 7 U.S.C. 25(b)(1) (1994). In 1983, when Section 25 was enacted into law, a CFTC regulation applicable to "[c]ontract market rules" (17 C.F.R. 1.41 (1982)) provided that, for purposes of the regulation, the term "contract market" would encompass "a clearing organization that clears trades for the contract market." 17 C.F.R. 1.41(a)(3) (1982). Congress's use of the phrase "rules of [a] contract market" should be construed in a manner consistent with that established understanding. Thus, the undisputed fact that petitioner's clearance of trades was subject to the rules of the NYCC is a sufficient basis for finding this statutory prerequisite to be satisfied.

The transactions at issue here were also subject to the rules of the NYFE. The NYFE Rules made Eisler's exercise of floor trading privileges contingent on petitioner's agreement to clear Eisler's trades. Those rules also required petitioner to assume the contractual obligations that Eisler's trades entailed, and they provided that petitioner was deemed to be the responsible buyer or seller on whose behalf those trades were made. In addition, the NYFE Rules governed the calculation of settlement prices, which were used to determine whether petitioner would be required to post additional margin or would instead collect gains from the NYCC. The applicability of the NYFE Rules makes it clear that the "transaction[s]" in which petitioner "engaged" were "on or subject to the rules of [a] contract market."

D. Allowing petitioner's suit to go forward is consistent with the history and purposes of Congress's decision to limit Section 25(b)(1)'s private right of action to plaintiffs who have

"engaged in" regulated commodity transactions on a futures exchange. The legislative history indicates that Congress sought to avoid speculative claims brought by persons who have not themselves participated in any transactions on a commodity market. The instant suit does not implicate that concern, because petitioner has alleged a financial loss resulting directly from its clearance of identified trades on the NYFE. And because the NYCC itself determined that petitioner's margin account deficit was approximately $4.5 million, petitioner's claim of pecuniary injury cannot be dismissed as speculative.

## ARGUMENT

### PETITIONER IS A PROPER PLAINTIFF UNDER 7 U.S.C. 25(b)(1)

#### A. A Plaintiff Need Not Satisfy The Requirements Of 7 U.S.C. 25(a) In Order To File Suit Under 7 U.S.C. 25(b)(1)

In holding that petitioner was not "'engaged in any transaction on or subject to the rules' of contract markets or other registered entities," and therefore was not a proper plaintiff under 7 U.S.C. 25(b)(1), the court of appeals relied in part on its antecedent determination that petitioner "did not fall within any of the categories enumerated in" 7 U.S.C. 25(a)(1)(A)-(D). Pet. App. 11a (quoting 7 U.S.C. 25(b)(1)); see *id.* at 9a-10a. That mode of analysis was misconceived. Section 25(a) and Section 25(b)(1) govern suits against different (and, indeed, mutually exclusive) classes of defendants, and they establish different tests for determining which plaintiffs may sue. Petitioner therefore did not need to satisfy the requirements of Section 25(a) in order to sue under Section 25(b)(1).

At the time of the events that gave rise to petitioner's current claims, Section 25(a)(1)(A)-(D) identified the plaintiffs to whom persons "*other than* a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association" could be held liable under the CEA. 7 U.S.C. 25(a)(1) (1994) (emphasis added). Respondents NYFE, NYCE, NYCC, and NYBOT were two contract markets, a clearing organization, and a board of trade respectively. Section 25(a)(1)(A)-(D) is thus inapplicable by its terms to the determination of respondents' potential liability.

The liability of contract markets, clearing organizations, and boards of trade is addressed not in Section 25(a) but in Section 25(b)(1). Section 25(b)(1) identifies the types of wrongdoing (*e.g.*, a "fail[ure] to enforce any bylaw, rule, regulation, or resolution that [the defendant] is required to enforce") that may subject such entities to liability. See 7 U.S.C. 25(b)(1)(A) (1994). In addition, by stating that such entities "shall be liable for actual damages sustained *by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade*," 7 U.S.C. 25(b)(1) (1994) (emphasis added), Section 25(b)(1) identifies the class of plaintiffs who may invoke the statutory right of action against contract markets, clearing organizations, and boards of trade.

In defining the potential liability of entities like respondents, Section 25(b)(1)(A) does not reference Section 25(a) or otherwise suggest that a plaintiff who sues such an entity must fall within one of the categories defined in Section 25(a)(1)(A)-(D). The absence of any such reference is particularly telling because Section 25(b)(2) and Section 25(b)(3) *do* contain cross-references to "subsection (a) of this section." 7 U.S.C. 25(b)(2) and (3) (1994). "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that

Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello* v. *United States*, 464 U.S. 16, 23 (1983) (citation omitted). Importing the limitations of Section 25(a)(1)(A)-(D) into Section 25(b)(1)(A) not only reads into Section 25(b)(1)(A) language that simply is not there, but also simultaneously renders superfluous the cross-references in Section 25(b)(2) and (3) that actually are in the statutory text. The structure of Section 25 as a whole thus belies any inference that a plaintiff who files suit under Section 25(b)(1) must fall within one of the categories defined by Section 25(a)(1)(A)-(D).

Undoubtedly there is a substantial *overlap* between the categories of potential plaintiffs under the two subsections. In particular, a person who "purchased" or "sold" a futures or option contract, see 7 U.S.C. 25(a)(1)(C) and (D) (1994), would be an obvious example of a person who "engaged in [a] transaction on or subject to the rules of [a] contract market or licensed board of trade," 7 U.S.C. 25(b)(1) (1994). But if the language of Section 25(b)(1) is otherwise properly construed to encompass FCMs that clear their customers' accounts, Section 25(a)'s use of the terms "purchased" and "sold" provides no basis for adopting a narrower reading. To the contrary, Congress's use of distinct terminology in the two subsections suggests that Section 25(b)(1)'s phrase "engaged in [a] transaction," without the limiting language "specified in subsection (a)" (which does appear in the next two subsections), does not incorporate the limitations imposed by Section 25(a)(1)(A)-(D). *Russello*, 464 U.S. at 23.

### B. In Its Role As Clearing FCM For First West's Trades, Petitioner "Engaged In" Regulated Commodity Transactions Within The Meaning Of 7 U.S.C. 25(b)(1)(A) (1994)

The phrase "engage in" is properly understood to mean, *inter alia*, "to begin and carry on an enterprise, esp. a business or profession," and "to take part: PARTICIPATE." *Webster's Third New International Dictionary* 751 (1963). In concluding that petitioner was not a proper plaintiff under 7 U.S.C. 25(b)(1)(A), the court of appeals stated that petitioner "functioned merely as a broker or agent that earned commissions for handling its customers['] trades." Pet. App. 9a. That characterization reflects a misunderstanding both of the role that a clearing FCM plays in effecting commodity transactions and of the legal obligations that a clearing FCM assumes. The NYFE and NYCC Rules that governed the transactions at issue here specifically addressed petitioner's role and responsibilities. Those rules specified that petitioner (1) served as principal obligor for Eisler's trades on the floor of the exchange, (2) played an essential role in the consummation of First West's transactions, (3) entered into a direct contractual relationship with the NYCC as part of those transactions, and (4) was financially liable to the clearinghouse for the decline in value of First West's positions. Those factors taken together identify petitioner as an entity that "engaged in" the relevant transactions. Indeed, the fact that the rules regulated petitioner's role in the transactions makes clear that petitioner engaged in transactions subject to the relevant rules.

1. Under the applicable NYFE Rule, every trade made by Eisler for First West's account was deemed to be "made *on behalf of*" petitioner as clearing member, and petitioner was treated as "the *buyer or seller of said contract* on the terms set forth therein." NYFE Rule 306(i)(2), NYFE Guide ¶ 2523.

at 2517 (Apr. 2002) (emphases added). That rule is in keeping with general custom in the industry: The initial buy-sell agreement that is formed on the floor of the exchange (*i.e.*, before the clearinghouse's assumption of obligations as part of the clearing process) is a trade *between FCMs*. Cf. NYBOT Rule 4.03(c) (floor trade initially constitutes binding oral contract "between the [Exchange] Members"). Petitioner thus directly "engaged in" the First West trades that allegedly caused its losses, because those trades were entered into "on behalf of" petitioner, who was treated as "buyer or seller."

2. Although Eisler was a licensed floor broker and a member of the NYFE, his eligibility to exercise floor trading privileges on the exchange depended by virtue of the NYFE Rules on the willingness of an NYCC clearing member to act as guarantor. NYFE Rule 118(a)(i), NYFE Guide ¶ 2231, at 2109 (Sept. 2000); see NYFE Rule 9, NYFE Guide ¶ 2017, at 2012 (Sept. 2000) (definition of "clearing member"); NYFE Rule 114, NYFE Guide ¶ 2211, at 2105 (Sept. 2000) (application and qualification of clearing members). To serve as Eisler's guarantor, petitioner agreed, *inter alia*, "to accept for clearance any transactions effected by the guaranteed member [Eisler] on or subject to the Rules of the [NYFE]." NYFE Rule 116(a)(i), NYFE Guide ¶ 2221, at 2107 (Sept. 2000). The NYFE Rules further required petitioner, as Eisler's clearing member, to "assume [each] contract in writing within one hour after receipt of a report from the trading member [*i.e.*, Eisler] identifying the terms thereof." NYFE Rule 306(i)(2), NYFE Guide ¶ 2523, at 2517 (Apr. 2002). Petitioner's essential practical role in effectuating Eisler's trades, as mandated by the NYFE Rules, further bolsters the conclusion that petitioner "engaged in" transactions subject to such rules.

3. Petitioner's service as clearing FCM for Eisler's trades also entailed the creation of a direct contractual relationship between petitioner and the NYCC rendering petitioner liable

for trading losses incurred as a result of the subject transactions. In keeping with industry custom and practice, the current ICE Clear US Rules (successor to the NYCC Rules that governed in May 2000, see note 5, *supra*) state that the clearinghouse, "by accepting a Contract offered to it for clearance by or on behalf of a Clearing Member," assumes each clearing FCM's obligations to the other party to the trade and in turn "succeed[s] to and become[s] vested with all rights and benefits accruing therefrom." ICE Clear US Rule 401(a); see generally 1982 Senate Report 188.

Those rules further explain that the liabilities and obligations of the clearinghouse "shall extend only to clearing members," and that the clearinghouse "shall not have any liability or obligation arising out of or with respect to any contract to any customer of a clearing member." ICE Clear US Rule 401(b)(i). The current rules of ICE Clear US are not aberrational, but rather accord with the CFTC's long understanding that "clearing organizations * * * generally have as their direct customers FCMs, not the ultimate 'customers' who entered into the futures contracts and options positions for which the [FCM's] margin funds were posted." 50 Fed. Reg. at 36,050; see pp. 6-7, *supra*. Thus, as Judge Friendly explained in a characteristically apt observation, clearing FCMs like petitioner are treated "as principals in trading transactions." *Leist*, 638 F.2d at 287. The fact that, under the relevant rules, each of Eisler's trades produced a contractual relationship between petitioner and the NYCC reinforces the conclusion that petitioner "engaged in" transactions subject to such rules.

4. As a result of the contractual commitments to the NYCC that petitioner's performance of clearing functions entailed, the NYCC Rules made petitioner liable to the clearinghouse for aggregate losses sustained in its customers' posi-

tions. See J.A. 173 (NYCC Rule 504(a)(i)).[12] The rules of the clearinghouse further provide that a clearing FCM is in "[d]efault," and subject to suspension as a clearing member, if, *inter alia*, it "fails to meet any of its obligations under its Contracts with the [clearinghouse]." J.A. 188 (NYCC Rule 801(a)). Indeed, in the instant case the NYBOT and the NYCC seized the entirety of petitioner's customer account—including funds attributable to customers other than First West—in an effort to enforce petitioner's obligation to make good on trades that it had cleared on behalf of First West. See Pet. App. 21a; p. 11, *supra*.

Petitioner's assumption of the financial risk entailed by Eisler's trades further supports the conclusion that petitioner "engaged in" the relevant transactions. The court of appeals stated that, "regardless of whether the First West trading position rose or declined in value, [petitioner] had no interest in any of the resulting profits or investment[] losses." Pet. App. 12a. The court concluded on that basis that "[petitioner's] loss was a credit loss, not a trading loss." *Ibid.* Those statements are erroneous.

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[12] By the same token, petitioner was entitled to payment from the clearinghouse for any trading day on which its customers' aggregate positions gained value. See J.A. 173-174 (NYCC Rule 504(a)(ii)). Respondents contend (Br. in Opp 10 n.5) that a clearing FCM is properly characterized "as an agent for undisclosed principals," and that "[t]he contract and the rights thereunder belong to the principal, not the agent." Respondents are mistaken. It is true that, pursuant to First West's separate contract with petitioner, petitioner would have been required to pay First West any financial gains that the trades executed by Eisler might have produced. The existence of that separate contractual undertaking, however, should not obscure the fact that the NYCC's own contractual rights and obligations were exclusively to petitioner, not to Eisler or First West. See ICE Clear US Rule 401(b)(i) (clearinghouse obligations extend only to clearing members, and the clearinghouse shall not have any obligations to customers of clearing members).

To be sure, if First West had promptly posted the required additional margin after the true extent of its losses became known, petitioner could have discharged its own obligation to the NYCC and thereby avoided any serious practical harm to itself from the decline in value of First West's positions. But even if petitioner's pecuniary injury was *in part* a "credit loss," it was a "trading loss" *as well*. By acting as clearing FCM for First West's trades, petitioner assumed a direct contractual obligation to pay the NYCC for any losses that First West's positions sustained. The existence and enforceability of that obligation arose directly from petitioner's role in the clearing process and were independent of First West's separate duty to reimburse petitioner for losses suffered on account of the trades.

The fact that petitioner's financial loss may have had more than one cause is scarcely anomalous. If property is damaged by fire, for example, and the owner's insurance company wrongly refuses to pay the resulting claim, both the fire itself and the insurer's conduct may properly be regarded as causes of the owner's ultimate financial loss. Similarly here, petitioner incurred substantial liability to the NYCC by acting as clearing FCM for futures and option positions that later declined in value. Petitioner's legal duty to pay more than $4 million to the NYCC on account of those transactions is properly characterized as a "trading loss," see Pet. App. 12a, even though petitioner's injury is *also* attributable to First West's failure to satisfy its own margin obligations.[13]

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[13] The effectuation of each of Eisler's trades involved a series of subsidiary steps—*e.g.*, the execution of the trade by Eisler on the floor of the NYFE "on behalf of" petitioner as clearing FCM, NYFE Rule 306(b)(2), NYFE Guide ¶ 2523, at 2517 (Apr. 2002); the "assum[ption]" of the trade by petitioner as clearing FCM, *ibid.*; and the clearance of the trade through the clearinghouse, whereby the clearing FCMs' obligations to each other were replaced by reciprocal obligations running between each FCM and the NYCC. Those subsidiary steps for each trade are properly viewed as components of a single

### C. The Transactions In Which Petitioner Engaged Were "On Or Subject To The Rules" Of Both The NYCC And The NYFE

At the time of the events that are alleged to give rise to liability in this case, Section 25(b)(1) of Title 7 identified as a potential plaintiff any "person who engaged in any transaction *on or subject to the rules of [a] contract market or licensed board of trade*." 7 U.S.C. 25(b)(1)(A) (1994) (emphasis added). The transactions at issue here satisfied the italicized condition because, as already noted, those transactions were subject to the rules of both the NYCC and the NYFE. Indeed, the fact that petitioner's own role in the transactions was pervasively addressed by the NYCC and NYFE Rules underscores that petitioner was a key participant, *i.e.*, "engaged in" the transactions.

1. Respondents acknowledge that, "[a]s a clearing broker, Petitioner dealt with the clearinghouse NYCC and cleared customer trades, subject to NYCC's rules." Br. in Opp. 14. Respondents contend, however, that, under the version of Section 25(b)(1) that was in effect in May 2000, coverage of the relevant transactions by the rules of the NYCC was insufficient to trigger the private right of action. See *ibid.* The thrust of respondents' argument is that the reference in former Section 25(b)(1) to "rules of [a] contract market or licensed board of trade" did not encompass rules of a clearing organization. That contention lacks merit.[14]

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overall "transaction" within the meaning of Section 25(b)(1). Alternatively, treating each subsidiary step as a distinct Section 25(b)(1) "transaction," petitioner "engaged in" each of those steps and is accordingly a proper plaintiff in this case.

[14] It is undisputed that a person who "engaged in" a transaction subject to the rules of a clearinghouse such as the NYCC or ICE Clear US would be a proper plaintiff under current 7 U.S.C. 25(b)(1). See Br. in Opp. 21-22; note 1, *supra*.

When Congress amended the CEA to create an express private right of action (see p. 2, *supra*), a CFTC regulation addressing "[c]ontract market rules" (17 C.F.R. 1.41 (1982)) provided that, for purposes of the regulation, "[t]he term 'contract market' includes a clearing organization that clears trades for the contract market." 17 C.F.R. 1.41(a)(3) (1982) (repealed 2001). When it promulgated that rule in 1976, the CFTC explained that for these purposes, "a meaningful distinction cannot be drawn between the rules of the clearing organization and those of the contract market." 41 Fed. Reg. 40,093. The reference to "rules of [a] contract market or licensed board of trade" in 7 U.S.C. 25(b)(1) (1994) is properly construed to incorporate that understanding. See, *e.g.*, *Goodyear Atomic Corp.* v. *Miller*, 486 U.S. 174, 184-185 (1988) (Court "generally presume[s] that Congress is knowledgeable about existing law pertinent to the legislation it enacts"); cf. *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978) (Congress is ordinarily presumed to be aware of an administrative or judicial interpretation of a statute, and to approve that interpretation when it re-enacts a law or incorporates existing statutory language into a new enactment).

2. In any event, even if respondents' argument concerning the NYCC Rules were correct, petitioner would still be a proper plaintiff because the "transaction[s]" in which petitioner "engaged" were subject not only to the rules of the NYCC, but also to the rules of the NYFE, a "contract market" within the meaning of the CEA. Those rules included NYFE Rule 306(i)(2), NYFE Guide ¶ 2523, at 2517 (Apr. 2002), which provided that "[e]very contract made on the Exchange shall be assumed by a" clearing member of the Exchange (*i.e.*, petitioner) and "shall be made on behalf of a clearing member who shall be the buyer or seller of said contract." See p. 20, *supra*. In addition, NYFE Rule 315, NYFE Guide ¶ 2541, at 2522 (Apr. 2002), governed the computation

of settlement prices and thus ultimately controlled the amounts of margin that petitioner was required to post. See pp. 8-9, *supra*. The transactions were also subject to NYFE Rules 116 and 118, NYFE Guide ¶¶ 2221, 2231, at 2107, 2109 (Sept. 2000), under which petitioner's agreement to act as clearing member was a prerequisite to Eisler's exercise of floor trading privileges. See p. 21, *supra*.

In arguing that petitioner's performance of its clearing responsibilities did not involve transactions "on or subject to the rules of [a] contract market," respondents appear to treat the clearing process as a self-contained transaction, exclusively within the domain of the NYCC, that was wholly separate and severable from the underlying trades by First West. See Br. in Opp. 14-16. That characterization is mistaken. Under the rules of the NYFE, the clearance of trades was an integral part of the overall process by which the trading decisions of persons (like Eisler and First West) other than clearing FCMs were put into effect. That is particularly apparent from NYFE Rules 116 and 118, NYFE Guide ¶¶ 2221, 2231, at 2107, 2109 (Sept. 2000), which conditioned Eisler's very ability to trade on access (through a clearing FCM) to the clearing process.

Thus, petitioner as clearing FCM was directly and substantially involved in the effectuation of the underlying trades. Those larger transactions were clearly "on [and] subject to" the rules of the NYFE, 7 U.S.C. 25(b)(1), even though the details of the clearing process were governed by the rules of the NYCC. Even if the reference in 7 U.S.C. 25(b)(1) (1994) to "rules of [a] contract market" did not encompass the rules of the NYCC, petitioner therefore would still be a proper plaintiff in this case.

### D. Petitioner's Invocation Of The CEA's Private Right Of Action Is Consistent With The History And Purposes Of Section 25(b)(1)

The CEA was amended in 1983 to create an express private right of action against, *inter alia*, a contract market, clearing organization, or board of trade. The House Report that accompanied the 1983 CEA amendments stated that "[t]he cause of action [against those defendants] would be restricted to cases where the plaintiff had engaged in a regulated commodity transaction." H.R. Rep. No. 565, 97th Cong., 2d Sess. Pt. 1, at 57 (1982) (1982 House Report). The 1982 House Report explained that the Committee intended "to avoid suits for speculative damages to assets that are affected by fluctuations in prices on the commodity market but which are not the subject of transactions on such market." *Ibid.*

The 1982 House Report's description of the persons who may invoke Section 25(b)(1)'s private right of action (*i.e.*, persons who have "engaged in a regulated commodity transaction," 1982 House Report 57) tracked the language of the enacted law and did not further specify the categories of plaintiffs who may file suit.[15] Petitioner's current suit, however, is

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[15] Respondents rely (Br. in Opp. 19-20) on the "Additional Views" stated in 1982 by Representative Glickman, who urged that the CEA be amended to make explicit that "commodity investors who suffer actual damages [have] the right to sue both brokers and exchanges for violations of the [CEA]." 1982 House Report 239. In urging Congress to eliminate any perceived ambiguity as to whether "commodity investors" may sue, however, Representative Glickman did not purport to define the precise scope of the new express private right of action. That is particularly clear because Representative Glickman's reference to commodity investors' "right to sue both brokers and exchanges" encompassed both Section 25(a) (which governs suits against brokers) and Section 25(b)(1) (which governs suits against exchanges). Representative Glickman's capsule description of the new express private right of action therefore cannot reasonably be understood as a gloss on the phrase "engaged in any

fully consistent with the stated rationale for limiting the right of action under Section 25(b)(1) to plaintiffs who have engaged in transactions on a commodity market. The gravamen of petitioner's suit is that, as a clearing FCM, it assumed direct financial responsibility for specific trades, without receiving adequate margin from First West and without an accurate understanding of the risks that the transactions entailed, because the relevant NYFE committee, knowingly and in bad faith, miscalculated settlement prices for P-tech futures and options. See J.A. 30 (Compl. ¶¶ 121-124). Petitioner's alleged losses thus resulted from its own direct participation in specific transactions that indisputably occurred on a futures exchange. And petitioner's claim of pecuniary injury is not speculative, because the NYCC itself determined, based on revised settlement prices computed without Eisler's participation, that petitioner's margin deficit was approximately $4.5 million. See Pet. App. 5a, 19a-20a.[16]

Petitioner alleges that it participated in actual commodity-market transactions, that it assumed contractual obligations as a result of those trades, that the positions it was carrying declined in value, and that it suffered pecuniary harm as a result. Allowing suits like petitioner's to go forward is fully consistent with the history and purposes of Section 25(b)(1), and will further the goals of the Commodity Exchange Act by providing an appropriate level of deterrence of future violations.

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transaction," which appears in the latter provision but not in the former. See pp. 17-19, *supra*.

[16] Petitioner's complaint alleged total damages in excess of $25 million, based in part on the collapse of petitioner's business and the damage to its reputation. See, *e.g.*, J.A. 39 (Compl. ¶¶ 156-157). This case presents no occasion for the Court to determine the precise scope of the "actual losses that resulted from such transaction" that may be recovered by a plaintiff who satisfies the requirements of Section 25(b)(1).

## CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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No. 06-1265

IN THE
# Supreme Court of the United States

KLEIN & CO. FUTURES INC.,

*Petitioner,*

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., *ET AL.*,

*Respondents.*

**On Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## BRIEF OF *AMICUS CURIAE* FUTURES INDUSTRY ASSOCIATION, INC. IN SUPPORT OF PETITIONER

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Pursuant to this Court's Rule 37.2, *amicus curiae* respectfully files this brief in support of petitioner.*

## STATEMENT OF INTEREST OF *AMICUS CURIAE*

The futures industry is a major engine of the American economy: every day, more than *$5 trillion* worth of futures contracts and related options are traded on futures exchanges in this country. The Futures Industry Association (FIA) is a national trade association for that industry. Its regular membership consists of 35 of the Nation's largest futures brokerage firms, and its associate membership consists of approximately 150 firms involved in virtually all other segments of the industry. FIA regular members execute customer orders for, and provide the financial guarantees underwriting, more than 90% of all transactions on the United States futures markets. Petitioner Klein is not, and never has been, an FIA member; respondents New York Clearing Corporation and Board of Trade of the City of New York are associate members. Neither regular nor associate members are bound by the views taken by FIA as *amicus*.

FIA has a strong interest in any case that affects the futures industry, and has participated as *amicus curiae* in several such cases, including *eBay, Inc. v. MercExchange, LLC*, 126 S. Ct. 1837 (2006), *Dunn v. CFTC*, 519 U.S. 465 (1997), and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982). FIA has a particularly strong interest in cases involving the interpretation of the Commodity Exchange Act (CEA), the federal statute that establishes the regulatory framework governing the

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* Pursuant to this Court's Rule 37.6, *amicus* states that no counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus* has made a monetary contribution to the preparation or submission of this brief. All parties have consented to the filing of this brief *amicus curiae*, and their consent letters are on file with the Clerk's Office.

futures industry and the relevant regulatory agency, the Commodity Futures Trading Commission (CFTC).

This case presents such an issue. As explained below, the Second Circuit misinterpreted the CEA's plain language to deprive clearing firms like petitioner of their statutory cause of action against statutory "registered entities" like respondents. That error affects the interests not only of the parties to this case, but of the entire futures industry, by exposing clearing firms to substantial financial harm resulting from bad faith misconduct by registered entities without any remedy against those entities. Because that decision threatens to destabilize those firms whose capital provides the financial backbone for this important industry, FIA hereby files this brief supporting petitioner.

## BACKGROUND

Because the decision below displays a fundamental misunderstanding of the operation of futures markets, some background may be helpful.

Futures and related options contracts are traded on futures exchanges. Individual customers who wish to buy or sell futures contracts may not do so directly; rather, they must carry out their transactions through brokerage firms called futures commission merchants. Such merchants arrange for the execution of customer orders either through floor brokers in a trading pit or on a computerized trading screen, as specified in the rules of the relevant exchange.

When the terms of an offer to sell are accepted by the buyer (or vice versa) in the pit or on the screen, a trade occurs. Under exchange rules, however, a given trade cannot be finalized until it is "cleared" to remove the risk that the underlying buyer or seller will not perform their mutual obligations. This clearing process is integral to the efficient operation of the Nation's futures markets.

The clearing process is carried out through an exchange's "clearing house." Under exchange rules, those futures commission merchants that are members of the clearing house, also called "clearing firms," submit the trade to the clearing house. The clearing house confirms the details of the trade, and then substitutes itself as the seller to the buyer's clearing firm and the buyer to the seller's clearing firm. In this manner, the clearing house removes the underlying buyer's risk to the underlying seller and the underlying seller's risk to the underlying buyer. The clearing house has no contact with (and may not even know the identity of) the underlying buyer or seller; rather, the clearing house deals only with the clearing firms on a principal to principal basis.

To protect itself from risk, a clearing house requires clearing firms to guarantee their ability to pay the aggregate losses on the contracts they carry on behalf of their customers. The clearing firms provide this guarantee through accounts they maintain at the clearing houses. At the end of each trading day, the relevant exchange determines (either through a committee or other means) the "settlement price" for each commodity futures contract and related option traded on that exchange. The clearing house then applies the settlement price to the open customer positions in the clearing firms' accounts, and adjusts those accounts accordingly. Losses are debited from the clearing firm's account, and gains are credited to the clearing firm's account. Through this daily adjustment process, the clearing firms make good on their obligations to the clearing house *regardless* of whether the underlying buyers and sellers make good on their obligations to the clearing firm. The clearing firm, in other words, is financially responsible to the clearing house for all the trades that it clears.

This case involves trades by one Norman Eisler, who was then Chairman of respondent New York Futures Exchange (a wholly owned subsidiary of respondent New York Cotton Exchange, which in turn is a wholly owned

subsidiary of respondent Board of Trade of the City of New York). In that capacity, Eisler was a member of the settlement committee for Pacific Stock Exchange Technology Index Futures (P-Tech futures and options), which set the daily settlement price for such trading instruments. Eisler carried out his own trading through a company called First West Trading.

As relevant here, First West hired petitioner Klein, a clearing firm, to submit the trades for clearing to the clearing house for the New York Futures Exchange, respondent New York Clearing Corporation. The problem here arose because (according to the allegations in petitioner's complaint, which must be taken as true at this stage of the proceedings) Eisler abused his position as Chairman of the New York Futures Exchange and a member of the P-Tech settlement price committee in an attempt to enrich himself. Pet. App. 3a. In particular, he manipulated the settlement price of P-Tech options for nine months in 1999-2000 to ensure that his company's contracts appeared profitable and thereby avoid any margin calls from Klein. Pet. App. 3a-4a. When the New York Futures Exchange and the New York Clearing Corporation finally discovered and attempted to rectify this misconduct, the settlement price for P-Tech options was corrected almost overnight, causing a radical decline in the value of P-Tech options and substantial margin calls. Pet. App. 5a. First West then defaulted on its obligations to Klein, and Klein in turn defaulted on its own independent obligations to the New York Clearing Corporation. *See id.* Accordingly, Klein was forced out of business and brought this lawsuit.

## SUMMARY OF ARGUMENT

Section 22 of the CEA, codified at 7 U.S.C. § 25, creates two different causes of action. The first, set forth in Section 22(a), creates a cause of action against entities other than statutory "registered entities." The second, set forth in Section 22(b), creates a cause of action against

statutory "registered entities." Respondents here are statutory "registered entities." Accordingly, this case is governed by Section 22(b), not Section 22(a).

The Second Circuit, however, held that petitioner's claims against respondents failed as a matter of law because they failed to meet the requirements of Section 22(a). That holding is plainly erroneous for the simple reason that this is a Section 22(b) case, not a Section 22(a) case. The Second Circuit gave no explanation for applying the requirements of Section 22(a) to a claim under Section 22(b), and there is no reason in law or logic to do so. Because petitioner has stated a claim under Section 22(b), the judgment should be reversed.

Over and above its misreading of the statute, the Second Circuit displayed a fundamental misunderstanding of the operation of futures markets. In particular, the court appears to have assumed that futures clearing firms are not themselves on the hook for losses stemming from transactions cleared for their customers. That assumption is incorrect. Futures clearing firms are independently liable to futures clearing houses for losses arising from transactions undertaken on their customers' behalf. Thus, it makes sense for Congress to have given futures clearing firms like petitioner a cause of action against "registered entities" like respondents where (as alleged here) respondents' violations of their own rules caused petitioner's losses.

## ARGUMENT

### The Second Circuit Erred, And Destabilized The Nation's Futures Industry, By Stripping Clearing Firms Of Their Statutory Cause Of Action Against Registered Entities.

As a threshold matter, there can be no real dispute that the Second Circuit erred by construing the CEA to deprive clearing firms like petitioner of a cause of action against registered entities like respondents. Such a cause

of action is expressly conferred by Section 22 of the CEA, codified at 7 U.S.C. § 25, which authorizes claims against "[a] registered entity that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce" by "a person who engaged in any transaction on or subject to the rules of such registered entity to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions." *Id.* § 25(b)(1).

That is the beginning and the end of this case. There is no question that respondents are "registered entit[ies]." *See id.* § 1a(29) (defining "registered entity" to include "a board of trade designated as a contract market," "a derivatives transaction execution facility," and "a derivatives clearing organization"). Petitioner alleges that it is "a person who engaged in any transaction on or subject to the rules of such registered entit[ies]," *id.* § 25(b)(1), including most obviously clearing those trades subject to respondents' rules. Petitioner alleges that respondents "fail[ed] to enforce any bylaw, rule, regulation, or resolution that [they are] required to enforce" by permitting Eisler to fraudulently manipulate the P-Tech options settlement price, and that as a result petitioner suffered "actual losses ... caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions." *Id.*

The Second Circuit did not deny any of these straightforward points. Rather, the Second Circuit began its analysis by correctly noting that "Section 22 includes two types of claims": "Section 22(a) relates to claims against persons *other* than registered entities and registered futures associations," whereas "Section 22(b) deals with claims against [registered] entities and their officers, directors, governors, committee members and employees." Pet. App. 7a (emphasis added; citing 7 U.S.C. §§ 25(a), (b)). This case, as the Second Circuit recognized, involves a Section 22(b) claim: petitioner is

suing registered entities. *See* Pet. App. 8-9a; 11a. Such a claim, as the Second Circuit again recognized, is "available only to a private litigant 'who engaged in ... transaction[s] on or subject to the rules of a contract market.'" Pet. App. 8a (quoting 7 U.S.C. § 25(b)(1)-(3)).

The Second Circuit, however, never analyzed the critical issue whether petitioner is "a person who engaged in any transaction on or subject to the rules of" a contract market or other registered entity, 7 U.S.C. § 25(b)(1), within the meaning of Section 22(b). Instead, the Second Circuit simply assumed without analysis that a person pursuing a claim under Section *22(b)* is subject to the limitations applicable to a person pursuing a claim under Section *22(a)*. *See* Pet. App. 7-8a ("The text of the two subdivisions requires that a putative plaintiff fall within one of the four required relationships set forth in § 22(a)(1)(A-D)."); Pet. App. 9a ("[Petitioner] does not fall within any of the required subdivisions of § 22(a)(1)(A)-(D).").

That is a complete non sequitur. Sections 22(a) and (b) create different causes of action by different plaintiffs against different defendants. Section 22(a) creates a cause of action against non-registered entities (*i.e.*, intermediaries like traders and brokers), *see* 7 U.S.C. § 25(a), whereas Section 22(b) creates a cause of action against registered entities, including designated contract markets and clearing organizations, *see id.* § 25(b). The requirements of the cause of action under Section 22(a) are set forth in Section 22(a), while the requirements for the cause of action under Section 22(b) are set forth in Section 22(b). Nothing in the statute remotely purports to import the requirements for a Section 22(a) claim into Section 22(b), and there is no basis in law or logic for doing so. *See, e.g.*, *Russello v. United States*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the

disparate inclusion or exclusion.") (internal citation omitted); *see also Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co., Ltd.*, 484 U.S. 97, 106 (1987) (applying this principle to the CEA). The wholesale importation of Section 22(a) requirements into Section 22(b) is especially problematic because specific provisions of Section 22(b) expressly incorporate the provisions of Section 22(a), underscoring that Congress knew perfectly well how to accomplish such incorporation where it wished to do so. *See* 7 U.S.C. § 25(b)(2) (referring to "a person that engaged in any transaction specified in subsection (a) of this section"); *id.* § 25(b)(3) (same).

The Second Circuit did not dispute any of the foregoing canons of interpretation, or otherwise seek to justify its importation of Section 22(a)'s requirements into Section 22(b). Rather, the court appears to have taken that fateful step wholly by inadvertence. As respondents acknowledge, the court appears to have conflated the various defendants involved in this case (which originally included both non-registered entities liable under Section 22(a) in addition to registered entities liable under Section 22(b)). *See* Pet. Opp. 19 ("The text of the court of appeals' holding did not distinguish with any precision between Eisler, First West, the individual defendants, the exchange and the NYCC."). But the statute carefully creates different causes of action against different categories of defendants, so it is imperative for a court to "distinguish with ... precision" whether a given claim is brought under Section 22(a) or 22(b). If the Second Circuit had a reason for importing Section 22(a)'s requirements into Section 22(b), the court at a minimum should have disclosed that reason.

Respondents attempt to confuse matters by arguing that certain amendments to the CEA enacted in the year 2000, after the events at issue here, "recast the category of persons with standing to bring an action under Section 22(b)." Pet. Opp. 21. But, as the relevant legislative history makes clear, those amendments were merely

"technical and conforming." S. Rep. No. 106-390, at 13 (2000); H.R. Rep. No. 106-711, pt. 3, at 21-25, 60 (2000); H.R. Rep. 106-711, pt. 2, at 27-32, 72 (2000); H.R. Rep. 106-711, pt. 1, at 22-26, 41 (2000). In particular, Congress streamlined the statutory language by replacing the terms "contract market," "clearing organization of a contract market," and "licensed board of trade" with the term "registered entity," and then defining the latter term to incorporate the former terms. *See* Commodity Futures Modernization Act of 2000, Pub. L. 106-554, § 123 (2000); *see also* 7 U.S.C. § 1a(29) (defining "registered entity" to include "a board of trade designated as a contract market" and "a derivatives clearing organization").

The 2000 amendments thus brought about no substantive change in Section 22(b). Before 2000, a "contract market" or "clearing organization of a contract market" that failed to perform its enforcement duties could be sued by a person injured by "any transaction on or subject to the rules of such contract market," which included the rules of a "clearing organization of a contract market." 7 U.S.C. § 25(b)(1) (1999). Indeed, under the relevant CFTC regulations, a "contract market" specifically included the market's "clearing house." 17 C.F.R. § 1.41(a)(3) (1976); *see also Board of Trade Clearing Corp. v. United States*, No. 76-1905, 1978 U.S. Dist. LEXIS 20220 (D.D.C. Jan. 11, 1978) (upholding this regulation). And after 2000, a "registered entity" (which includes both "a board of trade designated as a contract market" and "a derivatives clearing organization") that fails to perform its enforcement duties can be sued by a person injured by a transaction "on or subject to the rules of such registered entity," 7 U.S.C. § 25(b)(1). To the extent that respondents suggest that the 2000 amendments affect the resolution of this case, in short, that suggestion is a red herring.

Respondents also attempt to confuse matters by insisting that clearing firms act as "agents" for the underlying buyers or sellers, who remain on the hook for

any losses caused by a transaction. *See* Pet. Opp. 5-17. That argument misses the point. While it is certainly true that clearing firms act on behalf of their underlying customers, and those underlying customers are required to cover any losses through margin payments to their clearing firms, the fact remains that the clearing firms are themselves *independently* liable to the clearing house. A clearing firm must cover any losses from the contracts it clears regardless of the underlying customer's ability to cover such losses. In other words, the underlying customer's failure to pay the clearing firm does not relieve the clearing firm of its *own* obligation to pay the clearing house for any loss incurred on behalf of that customer. This is why clearing firms like petitioner may incur "actual losses" resulting from "any transaction on or subject to the rules" of a registered entity. 7 U.S.C. § 25(b)(1). In this manner, clearing firms assume risks that securities brokers generally do not. *Cf.* H.R. Rep. No. 93-975, at 71 (1974) ("Often erroneously viewed as twins, there is little correlation in theory or in fact between the regulation of futures trading and the regulation of securities transactions.").

The Second Circuit thus displayed a fundamental misunderstanding of the futures industry by declaring that clearing firms have "no financial interest" in their transactions, and do not "face[] essentially the same risks as a purchaser or seller of commodities contracts." Pet. App. 12a. To the contrary, as this Court has recognized, such firms are "essential participants" in futures markets precisely because they are required to guarantee financially their customers' performance by honoring their own clearing obligations even if their customers default. *Curran*, 456 U.S. at 359-60; *see also Leist v. Simplot*, 638 F.2d 283, 287 (2d Cir. 1980) (Friendly, J.) (describing clearing firms as "principals in trading transactions"). Respondents cannot avoid that point by insisting that clearing firms like petitioner do not suffer "*trading* losses" (whatever that means). Pet. Opp. 5

(emphasis added). The statute is not limited to "trading losses"; rather it creates a cause of action for "actual losses" resulting from "any transaction on or subject to the rules" of a registered entity," which petitioner clearly has alleged.

Because a clearing firm guarantees its customers' performance, it makes perfect sense for Congress to have given such firms (as well as their customers) a cause of action against registered entities that cause them actual losses as a result of bad-faith misconduct. Indeed, this case underscores why it would make no sense to limit the cause of action to the underlying customers, since the underlying customer here (Eisler) is the very person who allegedly abused his exchange office to manipulate settlement prices and then defaulted on his obligations. *See* Pet. 9-11. Precisely because petitioner was required to honor its clearing obligations undertaken on Eisler's behalf, it suffered massive losses (and indeed was forced out of business) after Eisler defaulted. Given the financial liability of clearing firms in futures transactions, the Nation's futures markets would be seriously undermined if such firms could be left holding the bag as the result of bad faith misconduct committed by officials of registered entities.

The decision below, in flat disregard of Section 22(b), shifted the financial risk of misconduct away from the registered entities charged with enforcing the rules onto the clearing firms that are engaged in every futures transaction, thereby creating a disincentive for these firms to underwrite the very speculation and risk-taking upon which the futures markets depend. *See, e.g.*, *Curran*, 456 U.S. at 359-60 (noting that clearing firms "have an interest in maximizing the activity on the exchange"). If clearing firms are left without any meaningful recourse for losses caused by bad faith misconduct by registered entities, they will be less willing to risk their capital to finance needed trading activity. Since clearing firms are engaged in every transaction in

the futures markets, this reluctance could decrease the overall liquidity and depth of those markets, and result in greater fluctuations in the prices of basic commodities contrary to the national interest. *See, e.g., id.* at 358.

In sum, the decision below is both indefensible as a matter of law and disastrous as a matter of policy.

## CONCLUSION

For the foregoing reasons, this Court should reverse the judgment.

Respectfully submitted,

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